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In the Supreme Court of the United States

OCTOBER TERM, 1934

Nos. 489–490

IN THE MATTER OF THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY, Debtor

RECONSTRUCTION FINANCE CORPORATION, PETITIONER

v.

THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY et al.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RECONSTRUCTION FINANCE CORPORATION

OPINION BELOW

There was no opinion, either oral or written, in the District Court. The opinion of the Circuit Court of Appeals (R. 313) is reported in 72 F. (2d) 443.

JURISDICTION

The injunctional order of the District Court was entered November 22, 1933 (R. 101). Separate appeals were allowed on the same day, December 12,

1933, by the District Court (R. 163) and by the Circuit Court of Appeals (R. 278). These appeals were consolidated for hearing in the Circuit Court of Appeals (R. 298). That court affirmed the injunctional order on July 23, 1934 (R. 313) and entered two judgments accordingly (R. 332, 338). A petition for writs of certiorari was filed in this Court, and certiorari was granted on December 3, 1934. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

PRINCIPAL QUESTION PRESENTED

Where a debtor railroad and its properties are being administered in reorganization proceedings brought under Section 77 of the National Bankruptcy Act, as amended, c. 204, 47 Stat. 1474, has the bankruptcy court power (contrary to the rule in ordinary bankruptcy proceedings), summarily to enjoin the Reconstruction Finance Corporation, as the holder of secured notes of the debtor railroad, from selling the collateral security held by it, when such sale is authorized by the pledge agreement and does not require judicial proceedings?

STATUTES INVOLVED

The pertinent statutes and orders are set out in the Appendix to this brief pp. 1, 3, 4, 85–109, 126, 158.

STATEMENT

The facts appear of record as follows:

On June 7, 1933, The Chicago, Rock Island and Pacific Railway Company (hereinafter called the

debtor), an Illinois and Iowa corporation, filed a petition (R. 2) in the United States District Court for the Northern District of Illinois under Section 77 of the Bankruptcy Act, as amended, alleging that it was "unable to meet its debts as they mature", and that it desired to effect a plan of reorganization under the said section. On the same day an order was entered by the District Court finding that the petition was properly filed (R. 6).

No trustees were appointed at the time, and thereafter and until the appointment of trustees by the District Court on November 22, 1933 (R. 105), the debtor operated its railroads and other property itself, subject to the court's supervision. By orders entered August 28, 1933, and October 24, 1933, petitions of certain of the debtor's subsidiaries to effect plans of reorganization under Section 77 in connection with, or as a part of, the plan of reorganization of the debtor were allowed by the District Court (R. 26, 97).

The petitioner, Reconstruction Finance Corporation, a corporation of which all of the stock is owned by the United States of America, is a creditor of the debtor in the aggregate principal amount of $13,659,877.58, evidenced by notes of the debtor for that amount which matured March 1, 1934. As collateral security therefor the Reconstruction Finance Corporation holds in pledge $7,575,000 face amount of bonds of the debtor; $27,599,973.34 face amount (exclusive of $4,380,000 face amount pledged under the prior lien of a mortgage and held by the trustee or

trustees of such mortgage and on which Reconstruction Finance Corporation has a second lien) of bonds of companies other than the debtor; $747,492.51 face amount of receivers' certificates of a company other than the debtor; and an assignment of the debtor's distributive share (estimated by the debtor at $1,400,000) in certain assets of The Railroad Credit Corporation.

The notes of the debtor held by the Reconstruction Finance Corporation evidence loans made by it to the debtor, prior to the institution of the proceedings under Section 77. In accordance with Section 5 of the Reconstruction Finance Corporation Act (c. 8, 47 Stat. 5), which requires the approval of the Interstate Commerce Commission of loans to railroads, the Commission gave its approval of these loans in Finance Dockets Nos. 9384 and 9835 (R. 37). The reports of the Commission may be found in 184 I. C. C. 597, 735, and 189 I. C. C. 522. In these reports, which for the convenience of this Court, are set forth in the Appendix pp. 5, 26, 49, 67, the Commission found that the Reconstruction Finance Corporation would be adequately secured, if the collateral above-mentioned was pledged as security for the notes.

The notes provide that in case the debtor defaults either in paying principal or interest on said notes, or fails on notice to furnish additional collateral, or becomes insolvent or goes into receivership, that the Reconstruction Finance Corporation is authorized to sell said collateral through a broker or at public or

private sale, either for cash or upon credit, and without any demand, advertisement, or notice. The Reconstruction Finance Corporation is further authorized to purchase said collateral for itself. (For provisions of the notes see R. 45, 46, 47.)

The debtor is also indebted to five banks on notes in the aggregate principal amount of $4,125,000, in substantially the same form, likewise secured by collateral (R. 39).

After the institution of reorganization proceedings under Section 77 and until the entry (on November 22, 1933) of the District Court's injunctional order herein, all interest becoming due and payable on the notes held by Reconstruction Finance Corporation and these banks was duly paid by the debtor (R. 341). The payment of interest on the various notes held by the Reconstruction Finance Corporation was allowed from time to time upon petitions of the debtor (R. 17, 22, 36, 75).

On September 26, 1933, and prior to the appointment of trustees, the debtor filed in the District Court a petition (R. 37) which alleged that the value of the collateral securing each of said notes was substantially in excess of the amount of the notes; that if the holders of said notes should convert or sell the collateral, "it would cause a substantial and irreparable loss to the trust estate"; and that "in case of a forced sale of the said collateral at the present time, it might result in a substantial deficiency judgment against the Debtor herein, and would dilute the respective interests in

the trust estate", of the holders of the debtor's bonds, of other creditors and of the debtor itself. The petition asked the District Court for instructions as to the payment of interest due October 1; 1933, on one of the notes held by the Reconstruction Finance Corporation, and for a determination "whether the Court should enjoin and restrain the holders of the said collateral notes, *in the event of default in the payment of interest thereon*, or other default therein, from selling and converting the said collateral, or any part thereof." The petition further requested that *if the court should be of such opinion*, an injunctional order should be entered. (R. 40, 42, 43.) (Italics ours.)

Notice of the debtor's intention to present this petition was given to the Reconstruction Finance Corporation by registered mail addressed to it at Washington, D. C. (R. 56). No process was issued or even prayed for against the Reconstruction Finance Corporation, nor was it a party to the reorganization proceeding. On the day upon which the debtor's petition was filed with the District Court, the Reconstruction Finance Corporation appeared by counsel specially, and solely for the purpose of objecting to the jurisdiction of the court, for the reasons that the court had (1) no jurisdiction over its person, (2) no jurisdiction over or possession of the property, the sale of which was sought to be restrained and (3) no jurisdiction to grant in a summary proceeding the injunction subsequently

granted. (R. 75.) The banks entered similar appearances. (R. 68–75.)

In support of the debtor's petition, one of the protective committees (for the debtor's General Mortgage 4% Bonds), named as respondents herein, appeared on the same day, although not at the time a party to the debtor proceeding, and filed an answer (R. 59), asking that said District Court enjoin the sale of the collateral. Another protective committee, likewise not at the time a party, filed an affidavit of its Chairman, Dwight S. Beebe (R. 65), which stated that $145,749,000 face amount of bonds and *stock* of "the Debtor's system" were pledged with trustees under three of the debtor's mortgages; that *on information and belief*, "in certain events described in the Indentures under which the aforesaid Trustees are acting, such Trustees are given the right to sell such collateral"; that he wished "*to point out* that a decision holding that the Reconstruction Finance Corporation and the Banks should not be enjoined from selling" the collateral held by them "would also determine that the Trustees of the three Bond issues mentioned above had the right to sell" the collateral pledged with them; and "that *the contentions of the Committee are* (1) that in a proceeding under the new Section 77 of the Bankruptcy Act the Court has power to enjoin pledgees from selling collateral where it is essential in order to carry out the purpose of the proceeding, and (2) that it is essential to enjoin such sales in a case such as this where the collateral consists of obligations of the Debtor Sys-

tem in principal amount vastly exceeding the indebtedness" (R. 66, 67, 68). (Italics ours.) Neither in the debtor's petition nor in the affidavit of Mr. Beebe was there any allegation or statement made that the Reconstruction Finance Corporation had threatened, or intends, to sell the collateral in its possession.

Thereupon, on the same day (September 26, 1933), the District Court entered an order (R. 75) authorizing the debtor to pay the interest in the amount of $76,313.34, due September 30, 1933, on one of the notes of the Reconstruction Finance Corporation, but reserved decision on the other matters contained in the debtor's petition. It was stipulated in open court (R. 119) that the Reconstruction Finance Corporation and the banks might present arguments and file briefs on the merits, without waiving their special appearances. Under this stipulation, the Reconstruction Finance Corporation and the banks presented briefs challenging the legal sufficiency of the petition, as well as the jurisdiction of the court. No answers were filed by Reconstruction Finance Corporation and the banks and no evidence of any kind was introduced by any party.

Thereafter, on November 22, 1933, the District Court, without either oral or written opinion, issued an injunctional order, restraining the petitioner and the five banks from "* * * converting, selling or otherwise disposing of the collateral held by them as security for the promissory notes of the Debtor, or any part thereof, until further order of this Court."

The order was, by its terms, predicated on the assumption that the sale of the collateral in question would "* * * hinder, impede, obstruct, delay, and in effect prevent the orderly preparation and consummation of a plan of reorganization * * *" of the debtor, and that the injunction was "* * * necessary for the enforcement of the provisions of Section 77 * * *" (R. 101, 103, 104).

This order was entered upon the record, consisting of the debtor's petition, answer of one of the protective committees, the affidavit of Dwight S. Beebe, the special appearances of Reconstruction Finance Corporation and the banks, and affidavits of nonresidence, filed in behalf of three of the banks.

Appeals from said order were allowed by the District Court (R. 163) and by the Circuit Court of Appeals (R. 278) on December 12, 1933. These causes were subsequently consolidated for hearing by order of the Circuit Court of Appeals (R. 298). A hearing was had in the Circuit Court of Appeals on May 28, 1934; and on July 23, 1934, that court rendered an opinion affirming the order of the District Court (R. 313) and entered two judgments accordingly (R. 332, 338).

At this point we desire to direct this Court's attention to the fact that the opinion of the Circuit Court of Appeals contains six errors as to important facts, and that the conclusions of the Circuit Court of Appeals are largely predicated on these errors.

(1) The Circuit Court of Appeals stated (R. 325) that:

> Appellants have received and will probably continue to receive the prompt payment of interest upon their claims secured by the debtor's and its subsidiaries' bonds.

Although interest was paid as it became due upon the debtor's notes held by the Reconstruction Finance Corporation and the banks until the entry of the injunctional order, *no interest whatever, due thereafter*, has been paid (R. 341, 342). The notes held by the Reconstruction Finance Corporation and the banks matured on March 1, 1934 (R. 37), and the principal thereof has not been paid.

(2) The Circuit Court of Appeals stated (R. 325) that the District Court

> sought to protect the great mass of the debtor's creditors *without injuring the position of appellants* * * * (Italics supplied.)

In fact, when the debtor's petition for an injunction was filed the *listed* collateral held by the Reconstruction Finance Corporation as security for the debtor's notes had a market value based on last prior sales on the New York Stock Exchange of $4,020,950. As this Court may see from the table below, the market value of the said collateral as of December 15, 1934, was $3,095,582. In other words, the Reconstruction Finance Corporation has suffered since the injunction a shrinkage in market value of its *listed* collateral of $925,368 or 23.0 percent, which may be seen from the following table:

TABLE No. 1.—*Depreciation of market value of listed collateral from Nov. 21, 1933, to Dec. 15, 1934—The Chicago, Rock Island & Pacific Railway Co. (date of injunction, Nov. 22, 1933)*

	Face amount	New York Stock Exchange last sale prices		Market value	
		Nov. 21, 1933	Dec. 15, 1934	Nov. 21, 1933	Dec. 15, 1934
C. R. I. & P. 1st and refunding mtge. 4% bonds of 1934	$7,575,000	18½	15⅞	$1,401,375	$1,202,531
St. Paul & Kansas City Short Line 1st mtg. 4½% bonds of 1941	9,374,500	23	15¼	2,156,135	1,429,611
Rock Island, Ark. & La. R. R. Co. 1st mtg. 4½% bonds of 1934	3,862,000	12	12	463,440	463,440
Total collateral with a market	20,811,500			4,020,950	3,095,582

Actual and percentage decrease in market value, $925,368 (23.0%).

NOTE.—Table prepared by Railroad Division of the Reconstruction Finance Corporation.

It should also be noted that this loss does not take into account any additional loss sustained on *unlisted* collateral, which is not dealt in on any exchange and for which, accordingly, there is no established market value.

(3) The Circuit Court of Appeals stated (R. 314) that—

> *nine* wholly owned subsidiary railroad companies, whose properties were under *long-term leases to debtor were permitted to join with the principal debtor in its petition for reorganization.* (Italics supplied).

In fact, only *six* of the subsidiary railroad companies so permitted to join the principal debtor were under *long-term* leases to debtor (R. 92–93). Careful scrutiny of facts would have disclosed to the Circuit Court of Appeals that—

(i) The "Memphis Terminal" operates under *a lease terminable at will.* (R. 93.)

(ii) The "Omaha Terminal" operates under *a lease terminable at will.* (Ibid.)

(iii) The "Peoria Terminal" so far as appears from the record is *not leased at all.* (R. 92.)

This misapprehension is significant when we analyze the description used by the respondents in their brief in answer to the petition for writs of certiorari, of the collateral as "obligations of the debtor system".

(4) The Circuit Court of Appeals mistakenly assumes (R. 324) that if the collateral is sold a plan of reorganization in these proceedings will have to provide for all of the bonds of the debtor and its subsidiaries constituting the collateral held by the Reconstruction Finance Corporation. The Circuit Court of Appeals failed to notice that the subsidiaries, the bonds of which are listed below, are *not* parties to the reorganization proceeding.[1]

	Face value
Kankakee & Seneca Railroad Company 4½% Bonds	$352,000.00
Rock Island Improvement Company:	
Blue Island Shops Bonds	199,000.00
Cedar Rapids Terminal Bonds	369,732.99
Little Rock Mortgage Bonds	278,492.49
First and Collateral 5% Bonds	3,310,000.00
Trinity & Brazos Valley Receiver's Certificates	747,492.51
Trinity & Brazos Valley First Mortgage Bonds (now pledged under Colorado & Southern Mortgage; C. R. I. & P. has agreed to pledge them with Reconstruction Finance Corporation upon release from that Mortgage May 1, 1935)	4,380,000.00
Total	9,636,717.99

[1] It should be noted that on the date of the petition for the injunction only two (R. 26) were parties to the reorganization proceeding, though this number was subsequently increased prior to the District Court's order (R. 97).

Contrary to the implication of the Circuit Court of Appeals' opinion, there is no reason why the plan of reorganization will have to provide for the above securities at all.

(5) The Circuit Court of Appeals failed to note that The Railroad Credit Corporation, the debtor's right to share in the assets of which is included in the collateral, and which right is estimated by the debtor to have a value of $1,400,000 (R. 38), is a corporation entirely alien to the debtor or any of its subsidiary railroad companies. The sale or assignment by the Reconstruction Finance Corporation of this right cannot possibly affect a plan of reorganization of the debtor. The respondents (brief in answer to petition for writs of certiorari, p. 6) admit that this is not "an obligation of the debtor system."

(6) The Circuit Court of Appeals mistakenly assumes (R. 324) that a plan of reorganization is in preparation. On the contrary, it is admitted by the debtor's trustees that no plan of any sort is under consideration by the interested parties, in spite of the fact that under subdivision (d) of Section 77 the debtor is under a duty to file a plan. (See Appendix, p. 167.)

We further desire to direct this Court's attention to the fact that this case involves the propriety of the injunction as to collateral which consists of obligations of companies other than the debtor. Only $7,575,000 face amount of collateral held by the Reconstruction Finance Corporation consists of obligations of the debtor.

Respondents in their brief in opposition to the petition for writs of certiorari have argued as though *all* of the collateral consisted of obligations of the debtor, The Chicago, Rock Island and Pacific Railway Company. Their brief refers to the collateral as "obligations of the debtor system", as though all of the collateral were of a single class.

This is not the case. It appears from the petition for the injunction that the collateral pledged with the Reconstruction Finance Corporation consists of the following securities:

Listed Collateral:	
The Chicago, Rock Island and Pacific Railway Company First and Refunding 4% Gold Bonds	$7,575,000.00
St. Paul and Kansas City Short Line Railroad Company First Mortgage 4½% Gold Bonds	9,374,500.00
Rock Island, Arkansas and Louisiana Railroad Company First Mortgage 4½% Gold Bonds	3,862,000.00
Total	20,811,500.00
Unlisted Collateral:	
The Chicago, Rock Island and Gulf Railway Company Extension First Mortgage 5% Bonds	6,927,000.00
The Chicago, Rock Island and Gulf Railway Company Carrollton Branch 6% Bonds	331,000.00
Kankakee & Seneca Railroad Company 4½% Bonds	352,000.00
Rock Island and Dardenelle Railway Company First Mortgage 5% Bonds	100,000.00
Rock Island Memphis Terminal Depot First Mortgage 5% Bonds	900,000.00
Rock Island Memphis Terminal First Mortgage 5% Bonds	400,000.00
Rock Island Omaha Terminal First Mortgage 5% Bonds	906,000.00
Rock Island Improvement Company:	
Blue Island Shops Bonds	199,000.00
Cedar Rapids Terminal Bonds	369,732.99
Little Rock Mortgage Bonds	278,492.49
First and Collateral 5% Bonds	3,310,000.00
Trinity & Brazos Valley Receiver's Certificates	747,492.51

Unlisted collateral—Continued.	
Trinity & Brazos Valley First Mortgage Bonds (now pledged under Colorado & Southern Mortgage; C. R. I. & P. has agreed to pledge them with Reconstruction Finance Corporation upon release from that Mortgage May 1, 1935)	$4,380,000.00
Total	$19,200,717.99
Assignment of Company's distributive share in assets of Railroad Credit Corporation, approximately	$1,400,000.00

It does not appear from the petition (R. 37) (nor from the supporting affidavit (R. 65) of Mr. Beebe for that matter), on the basis of which the injunction was granted, that the debtor, The Chicago, Rock Island and Pacific Railway Comapny, is itself liable on any of the collateral, with the exception of the $7,575,000 of its own First and Refunding Gold Bonds.

Specifications of error

The Reconstruction Finance Corporation has assigned as error the holding—

(a) That the District Court had jurisdiction over petitioner in the premises;

(b) That, even if it had such jurisdiction, it had power to enjoin the petitioner from enforcing against the pledged collateral the terms of the notes;

(c) That this petitioner should be enjoined from selling the collateral held by it as security for the notes of the debtor;

(d) That this petitioner should be enjoined from selling the collateral held by it consisting of the secured obligations of companies other than the debtor;

(e) That the sale of such collateral would defeat the purposes of Section 77 of the Bankruptcy Act, as amended;

(f) That the District Court was justified in issuing the injunction on the record in this case; and

(g) That the order of the District Court should be affirmed.

This Court granted writs of certiorari on December 3, 1934.

SUMMARY OF ARGUMENT

I

The injunction under review was granted in a summary proceeding. It was assumed by the Circuit Court of Appeals that it could not have been granted in such a proceeding prior to the enactment of Section 77. The Circuit Court of Appeals stated it was an exercise of authority on the part of the court which was necessary to the effective use of powers expressly conferred by Section 77.

As shown under point II, the express provisions of Section 77 negative the implication of the power to grant the order either in a summary or a plenary proceeding, where the sale of the collateral (as here) is permitted by the terms of the pledge agreement and does not require judicial proceedings. The petition on which the order was granted is insufficient as a bill in a plenary suit. If a summary proceeding would lie the affidavit filed with the petition does not properly allege anything in support thereof.

II

In ordinary bankruptcy proceedings, the law has been well settled for many years that the court may not, under any provision of the Bankruptcy Act here applicable, enjoin the sale, either of the obligations of other companies, which constitute the bulk of the collateral held by this petitioner, or of the $7,575,000 face amount of the debtor's own obligations, likewise comprised in its collateral.

The common-law right involved, recognized both in bankruptcy and in equity receiverships, is not impaired by the enactment of Section 77, subdivision (n) of which provides that in proceedings thereunder and consistent with the provisions thereof, the rights and liabilities of creditors shall be the same as in ordinary bankruptcy proceedings. Furthermore, subdivision (1) of Section 77, which authorizes the court to stay "the commencement or continuance of any judicial proceeding to enforce any lien upon the estate" of the debtor, by expressly authorizing the court to stay only judicial proceedings, negatives the intent that the sale of collateral may be enjoined, when sold under a power of sale contained in the pledge agreement and without the aid of judicial proceedings. This construction alone gives effect to the words "commencement or continuance of any judicial proceeding." There is no other provision of Section 77 which in any way confers upon the court the power to issue injunctions. It should also be noted that subdivision (1) of Section 77 is applicable only to judicial proceedings to enforce "any lien." A pledgee of negotiable

securities has a greater interest therein than a mere lien. That the rule in ordinary bankruptcy has not been changed by the enactment of Section 77 is strengthened by the construction which several courts have placed upon a similar provision of Section 74 and by the legislative history of both enactments. Authority for the injunction is not granted by subclause 15 of Section 2 of the Bankruptcy Act, the so-called "omnibus clause," for, as this Court has held, subclause 15 of Section 2 must be construed with regard for the express provisions of the Bankruptcy Act which are applicable to this case. Subclause 15 of Section 2 has never in the past been construed to authorize a bankruptcy court to enjoin the sale of pledged collateral.

Regardless of these considerations, Section 77 must be construed with Section 5 of the Reconstruction Finance Corporation Act (under the authority of which the loans from this petitioner involved in this case were made), which expressly empowers the Reconstruction Finance Corporation to take over and liquidate collateral accepted by it as security for such loans. The express provisions of Section 5 of the Reconstruction Finance Corporation Act are controlling in this case, if they are to be given any pragmatic effect, consistent with the underlying purposes of the Reconstruction Finance Corporation.

Patently, this is not a case of a reconciliation of an earlier statute with a later enactment containing

inconsistent provisions. This Court should not permit a derivation of power from subclause 15 of Section 2 of the Bankruptcy Act, couched in *general* language, to prevail over a power *expressly* granted by Congress under Section 5 of the Reconstruction Finance Corporation Act.

III

The economic policy of financing railroads by short-term loans secured by pledge was recognized by the Congress in the Reconstruction Finance Corporation Act, and given specialized administrative control by the Interstate Commerce Commission; that policy should not be called into question as is done by the construction placed upon Section 77 by the decision of the Circuit Court of Appeals. Affirmance of that decision would endanger normal commerical processes. Uneconomic corporate holdings will tend to be perpetuated.

The supposed distinction between interruption of a remedy and impairment of a right is meaningless in this case. Since the injunction is predicated upon the assumption that it is necessary until a plan of reorganization for the debtor can be effected, the contractual right is invaded without substituting an equally efficient and adequate remedy.

The Congress, through the Reconstruction Finance Corporation Act, elected to follow the policy during the existing emergency of financing railroads by short-term collateral loans from this petitioner. Each

transaction is controlled by the Interstate Commerce Commission as guardian of the soundness of the financial policy involved. This amounts to a congressional determination of policy which should not be overridden by a strained statutory construction.

IV

The findings of the District Court that sale of the collateral, held by this petitoner and the banks, would in effect prevent the debtor's reorganization and that "it is necessary to the enforcement of the provisions of Section 77" that the sale of said collateral be enjoined "pending the preparation and consummation of a reorganization plan" are mere assumptions and nothing more.

Under the express provisions of Section 77, the note holder is entitled both to vote on his note and in the various classes of creditors in which the collateral falls; hence, there can be no such shifting of classes of creditors or changes in the size of the various classes of creditors as will prevent the preparation and effectuation of a plan. In any reorganization of the debtor the secured obligations of other companies comprised in this petitioner's collateral must be treated as outstanding, as they would have to be if they were still held in the treasury of the debtor. The validity of the pledge in this case is not questioned. To deny to the pledgee holding collateral the benefit of his contract is to give other creditors of the debtor,

and the debtor itself, an advantage for which they have not bargained.

The assumption that the injunction is necessary for the effectuation of a plan is entirely unsupported. No necessity has been shown.

On the contrary, the power to sell collateral, instead of tending to prevent the consummation of a plan, will in practice expedite it.

V

The present injunction purports to be a final disposition of the issue until a plan of reorganization under Section 77 can be effected. As a matter of fact, there is no plan proposed by any of the interested parties. Unless this Court now affords the relief to which this petitioner is entitled, the latter can have no assurance that it will not suffer irreparable injury.

ARGUMENT

Preliminary Statement

At the outset, it should be pointed out that unlike the cases in which certiorari has been granted to the banks, this case requires consideration by this Court of the acts relating to the creation by the Congress of the Reconstruction Finance Corporation and the statutory powers expressly granted to it (in particular, c. 8, 47 Stat. 5, and c. 520, 47 Stat. 709). These acts were not considered by the Circuit Court of Appeals in its opinion.

The position of the Reconstruction Finance Corporation also differs from the position of the banks because the Reconstruction Finance Corporation has not raised any constitutional issues whatever. The issues in this case may be delimited by bearing in mind that there is no room herein for the application of any broad principles of constitutional interpretation. So far as the pertinent legal questions are concerned, the instant case involves only the ordinary canons of statutory construction and the giving effect thereto.

I.

THE PETITION UPON WHICH THE ORDER UNDER REVIEW WAS ENTERED IS INSUFFICIENT.

The Circuit Court of Appeals below assumed that prior to the enactment of Section 77 the order could not have been entered except in a plenary proceeding. This is not such a proceeding.

The rule of law in question has not been changed by the enactment of Section 77 of the Bankruptcy Act. We shall develop this contention in point II of this brief. It is sufficient to note here that the debtor has gratuitously assumed that an order issuable only in a plenary proceeding, prior to Section 77, could issue in a summary proceeding after the enactment of that section; and the Circuit Court of Appeals below, without argument in its opinion, so assumed, and explicitly declined either to review the authorities or to justify its assumption by reasoning.

Yet the change is almost as drastic as well could be imagined. A vital right of a creditor could, on

this theory, be cut off even without formal notice to him of the complaint set forth in a pleading; without adequate consideration of the facts or the equities; without opportunity, in case he does not receive notice by mail to present his side, and, apparently, without even a chance to insist upon the safeguard of a bond to protect him against loss should he choose to appeal.

It becomes necessary, therefore, to analyze the opinion of the court below.

A. *Analysis of the opinion of the Circuit Court of Appeals.*

The extent to which the decision of the Circuit Court of Appeals extends the power of the District Court, contrary to long-established practice in ordinary bankruptcy, appears from a brief analysis of the decision of the Circuit Court of Appeals.

The rationale of the decision of the Circuit Court of Appeals appears in the following quotation (R. 324):

> Our conclusion is that the restraining order is an exercise of authority on the part of the court which is necessary to the effective use of the powers expressly conferred by Congress through this amendment. In short, it was the exercise of a power which was incident to those expressly conveyed by Congress to the court.

It was assumed by the court that, due to obvious jurisdictional objections, the order under review, having been entered in a summary proceeding could

not have been sustained as to the nonresidents enjoined "save as the amendment known as Section 77 of the Bankruptcy Act supplies the authority therefor" (R. 320), citing *Bardes* v. *Hawarden Bank*, 178 U. S. 524, 527; *Taubel-Scott-Kitzmiller Co., Inc.* v. *Fox*, 264 U. S. 426, 432.[2] As appears from the following quotation, the court did not discuss the contention made by the Reconstruction Finance Corporation that, prior to the enactment of Section 77, the order could not have been sustained against any of the petitioners (R. 320, 321):

> That the order may have been sustained under the Bankruptcy Act, before amendment under certain circumstances and as against creditors who occupy positions similar to some of the appellants, is earnestly asserted. We are, however, for brevity's sake avoiding a discussion of such questions because unnecessary.

See also the following:

> May the restraining order be issued in a summary proceeding? Again, we look to the 1933 amendment to find authority for the court to so proceed. (R. 323.)

Thus, for the foundation of the court's affirmance, reliance is made solely upon the 1933 amendment to the Bankruptcy Act. As will be set forth more fully under point II of this brief, Section 77 does not

[2] There would appear to be nothing in the doctrine of *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, which authorizes a bankruptcy court, lacking possession, to stay the sale of collateral. See also, *Straton* v. *New*, 283 U. S. 318.

contain any specific authority for a District Court to enjoin a pledgee from selling mortgage bonds validly issued by a debtor railroad or its subsidiaries and pledged to secure its debt, when such sale is authorized by the pledge agreement and does not require judicial proceedings. On the contrary, the express provisions of Section 77 negative the implication that the court has such power.

In their brief in opposition to petitions for writs of certiorari (p. 10), respondents make the contention that we must look elsewhere, to subclause (15) of Section 2 of the Bankruptcy Act (the so-called omnibus clause) as it has existed since prior to the enactment of Section 77, to supply the missing authority for the order of the District Court. But here, again, express authority is lacking, for the language is only general.

It is indisputable, and the Circuit Court of Appeals admits the fact in its decision, that the order of the District Court is without express statutory authorization (R. 324).

B. *In a plenary proceeding the necessary allegations for the issuance of an injunction must be made out in the petition for the injunction, and omissions may not be supplied by a supporting affidavit.*

The record on which the injunction was issued consists solely of the debtor's petition (R. 37); an answer of one of the protective committees (R. 59); the affidavit of Dwight S. Beebe (R. 65); the special appearances of Reconstruction Finance Corporation

and the banks, and affidavits of nonresidence, filed in behalf of three of the banks (R. 68–75).

It is well settled that, in a plenary proceeding, where a petition is filed praying for the issuance of an injunction, the petition itself must state the facts which are urged as the basis for the injunction. Omissions in the petition may not be supplied by statements in a supporting affidavit.

In *Missouri Pacific R. R. Co.* v. *Norwood*, 283 U. S. 249, the railroad filed a complaint supported by certain affidavits praying for a temporary injunction to restrain certain officials of Arkansas from enforcing statutes of that state regulating freight-train crews. This Court affirmed a decision of the lower court dismissing the complaint because it was insufficient to show any ground for relief. This Court stated (p. 253):

> It [the plaintiff] maintains that the allegations of the complaint together with the facts set forth in the affidavits show that, when applied to operating conditions on its lines in Arkansas, these state laws are arbitrary and violative of the Federal Constitution and laws. But the affidavits filed in support of the application for a temporary injunction may not be considered in determining whether the complaint states facts sufficient to constitute ground for relief. *Leo* v. *Union Pac. Ry. Co.*, 17 Fed. 273. *United States* v. *Marine Engineers' Assn.*, 277 Fed. 830, 834; *McGregor* v. *Great Northern R. Co.*, 42 N. D. 269, 280; 172 N. W. 841.

To the same effect see *United States* v. *Marine Engineers' Ass'n*, 277 Fed. 830, 834, cited in the foregoing case; and *Leo* v. *Union Pacific Ry. Co.*, 17 Fed. 273. These cases are equity cases, but are applicable to the present case, since the ordinary equity procedure applies in bankruptcy proceedings. See General Order in Bankruptcy 37; *Bardes* v. *Hawarden Bank*, *supra*, at 535; *Fidelity Trust Company* v. *Gaskell*, 195 Fed. 865; and *In re Cunningham*, 40 F. (2d) 270, 271, where the court said:

> It is well settled that courts of bankruptcy are governed by the principles and rules of equity in their procedure, except where deviation is authorized by general order or by an act of Congress.

C. *In a plenary proceeding, the allegations of the debtor's petition would be insufficient to justify its issuance.*

The Reconstruction Finance Corporation submits the above proposition because the debtor's petition fails to allege:

(1) That the court has jurisdiction over the defendant;

(2) That the court has power to issue the order in a summary proceeding;

(3) That the debtor is unable to continue paying the interest due from time to time upon the collateral notes;

(4) That any of the obligations of subsidiary companies are guaranteed by the debtor;

(5) That any difficulties will be caused in handling the reorganization in case the pledged securities are sold;

(6) That any default has occurred which would entitle the pledgees to sell their collateral;

(7) That any of pledgees have threatened, or claim the right, to sell their collateral;

(8) That any plan of reorganization has been proposed which the sale of the collateral might obstruct or that it is impossible to draw a plan unless such sale is enjoined.

It should also be noted that the petition for the injunction is based on the following contentions: (a) that the value of the collateral securing each of the debtor's notes to the Reconstruction Finance Corporation was substantially in excess of the amount of the note; (b) that if the holders of said notes should convert or sell the collateral, "it *would cause a substantial and irreparable loss to the trust estate*"; (c) and that "in case of a forced sale of the said collateral at the present time, *it might result in a substantial deficiency judgment* against the Debtor herein, and would dilute the respective interests in the trust estate" of the holders of the debtor's bonds, of other creditors and of the debtor itself. We beg particularly to call to the attention of this Court that the contention of the debtor that a sale of the collateral "would cause a substantial and irreparable loss to the trust estate" is inconsistent with the contention that "it might result in a substantial deficiency judgment." (R. 40, 42, 43). (Italics supplied.)

D. *The omissions from the debtor's petition, moreover, are not remedied by any facts affirmatively alleged in the supporting affidavit of Dwight S. Beebe, and this is so, even if it may be considered as supplementing the petition.*

Assuming (as does the Circuit Court of Appeals) that, prior to the enactment of Section 77, the order could not have been entered except in a plenary proceeding, and further assuming (as we show later in this brief) that the law has not been changed by the enactment of Section 77, the injunction can not be supported by reference to the general record in this case. In order to show the nature and history of this proceeding, the various railroads which have intervened as parties, and the appointment of the trustees, parts of the record other than the petition and affidavit for the injunction have been included in the printed record filed with this Court; but the respondents may not supply defects in the petition for the injunction by reference to other pleadings included in the record. If we may correctly assume that, prior to the enactment of Section 77, the order could not have been entered in a plenary proceeding, and that the law has not been changed by the enactment of Section 77, the injunction, according to the rule laid down in the cases already cited, should be reversed if the allegations of the petition are insufficient to show its necessity.

But, should the rule which we contend is applicable to this case, be held not applicable, the omissions

from the debtor's petition are not remedied by any facts affirmatively alleged in the affidavit of Dwight S. Beebe (R. 37), on the basis of which and of the debtor's petition (R. 65) *only*, the injunction was entered, no issue of fact being raised or tried, and no evidence whatever being heard.

In a plenary proceeding which, we contend, is the only type of proceeding in which the right of the Reconstruction Finance Corporation to deal with the collateral according to the terms of the contract can be questioned, supporting affidavits are not properly part of the petition.

And even if it be held that an injunction could issue in a summary proceeding in a situation such as is here presented, the affidavit of Mr. Beebe is fatally defective for the following reasons:

(1) The reference in the affidavit to the "necessity" for the injunction in order to carry out the purposes of Section 77 (R. 68) is not an *allegation of fact*. It is merely alleged that "the contentions of the committee", which Mr. Beebe represents, are to this effect. Even if the allegation in this form had appeared in the petition itself, it would not be admitted by failure to deny in the lower court, since only properly pleaded *facts* are admitted, not statements of "contentions" of parties on points of law. *Missouri Pacific R. R. Co.* v. *Norwood*, *supra*.

(2) Neither is the reference in the affidavit to $145,749,050 face amount of bonds and *stock* of "the Debtor's system" pledged with the trustees of three of the debtor's mortgages an allegation of *fact*.

It is merely alleged on "information and belief" that "in certain events" (not enumerated) "described in the indentures under which the aforesaid trustees are acting, such trustees are given the right to sell such collateral." The affidavit states (R. 67): "On behalf of the Committee, I request permission to submit to the court upon the hearing of the debtor's application copies of any one or more of such indentures." This suggestion was never followed up, and no indentures were ever submitted to the court.

The affidavit continues (R. 67):

> On behalf of the Committee, I wish to point out that a decision holding that the Reconstruction Finance Corporation and the Banks should not be enjoined from selling the $54,710,000 face amount of collateral held by them *would also determine that the Trustees of the three Bond issues mentioned above had the right to sell*, in accordance with the terms of the above-mentioned Indentures, the $145,749,050 total face amount of capital obligations of the System pledged with them. (Italics supplied.)

Not only is this statement not an allegation properly before the court; it is also a perfectly indefensible conclusion.

It is clear that the affirmance or reversal of the present injunction will not operate as a precedent for the sale of any collateral held by the trustees under these indentures. The type of collateral held by the trustees (consisting, to a substantial extent, of stock) (R. 66) and that held under the terms of the pledge are totally different; the loans secured under the trust agreement are long-term loans, not short-term loans

made in reliance on the right to a quick conversion of the security.

E. *Regardless of the sufficiency of the petition, it should be noted there was no service of process on Reconstruction Finance Corporation.*

The record shows (R. 56) that the Reconstruction Finance Corporation was never served with process of any kind. The Reconstruction Finance Corporation, by the stipulation entered into in open court (R. 119) has not in any way, by presenting arguments or filing briefs on the merits, waived its objection to the failure to obtain personal service upon it. Since this question will be fully discussed in the brief submitted to this Court on behalf of the nonresident banks, it is submitted to this Court by the Reconstruction Finance Corporation without further argument.

II

THE DISTRICT COURT MAY NOT RESTRAIN A PLEDGEE FROM SELLING PLEDGED COLLATERAL UNDER ANY PROVISION OF THE BANKRUPTCY ACT HERE APPLICABLE

A. *The law as it existed prior to the enactment of Section 77*

Sections 57 (h) and 67 (d) (Appendix, pp. 85, 86) expressly provide for the protection of liens. Construing these provisions, the courts have uniformly held that bankruptcy of the pledgor does not deprive the pledgee of any rights secured to him under his contract. *Hiscock* v. *Varick Bank of New York*, 206 U. S. 20; *Jerome* v. *McCarter*, 94 U. S. 734;

Taney v. *Penn Bank*, 232 U. S. 174; *In re Hudson River Navigation Corporation*, 57 F. (2d) 175; *In re Browne*, 104 Fed. 762. An order of the Bankruptcy Court restraining the sale of collateral may issue only where the circumstances of the case come within the provisions of Sections 60 (b), 67 (e) or 70 (e) of the Bankruptcy Act (Appendix, pp. 85, 86, 87), none of which are applicable to this case.

The decisions dealing with the matter may be appropriately classified into three groups, based upon the three different factual situations most often presented.

(i) Where the pledged collateral consists of obligations of a corporation other than the insolvent debtor (*as does all of the collateral held by the Reconstruction Finance Corporation in this case*, except $7,575,000 of the debtor's first and refunding bonds), the sale of the collateral may not be enjoined.

In re Hudson River Navigation Corporation, 57 F. (2d) 175, 175–176;
Hiscock v. *Varick Bank of New York*, 206 U. S. 28, 41;
In re Mertens, 144 Fed. 818;
In re Browne, 104 Fed. 762;
In re Mayer, 157 Fed. 836.

(ii) Even where the pledged collateral consists of *secured* treasury obligations of the insolvent debtor itself (such as the $7,575,000 of the debtor's first and refunding bonds pledged with the Reconstruction Finance Corporation) the sale of such collateral may not be enjoined.

Jerome v. *McCarter*, 94 U. S. 734, 739;

Guaranty Trust Co. of New York v. *Galveston City Railroad Company*, 87 Fed. 813, 815;

In re Ironclad Manufacturing Company, 192 Fed. 318; also same case, 190 Fed. 320;

Turner v. *Metropolitan Trust Company*, 207 Fed. 495, 499–500;

Rogers Brown & Co. v. *Tindel Morris Co.*, 271 Fed. 475, 476–477;

Apparently contra:

Mississippi Valley Trust Co. v. *Railway Steel Spring Co.*, 258 Fed. 346, 351.

(iii) Where the pledged collateral consists of *unsecured* treasury obligations of the insolvent debtor itself (neither the Reconstruction Finance Corporation nor the banks in this case hold any pledged obligations of this sort), it has been held that the court may enjoin the sale of such obligations on the theory that the collateral consists merely of a multiplication of the number of promises to pay the same debt.

John Matthews, Inc. v. *Knickerbocker Trust Co.*, 192 Fed. 557.

We will discuss these groups of cases in the order numbered.

(i) Where the pledged collateral consists of obligations of a corporation other than the insolvent debtor (*as does all of the collateral held by the Reconstruction Finance Corporation in this case*, except $7,575,000 of the debtor's first and refunding bonds) the sale of the collateral may not be enjoined.

For many years it has been well settled that pledgees holding in their possession collateral, consisting of obligations of a corporation other than that of the debtor, have the unrestricted right to sell the collateral when they choose, in spite of the bankruptcy of the pledgor. In this respect, the rule in equity receiverships is the same as the rule in ordinary bankruptcy. The reasons for its adoption are compelling, particularly when, as in this case, the vital and substantial part of the short-term creditor's contract is his right upon default to choose the time to liquidate his loan by a sale of the pledged collateral. These reasons are well stated in the recent opinion of the Circuit Court of Appeals of the Second Circuit in *In re Hudson Navigation Corporation*, 57 F. (2d) 175, where Judge Learned Hand said:

> For practical purposes the pledgee has therefore immediate dominion as between the two, and with it goes the power to resist any action by the bankruptcy court, which ust be founded on the fact that the bankrupt had such dominion, when the petition was filed. This was implicit in our ruling in *In re Mertens*, 144 F. 818, and we directly held so in *In re Mayer*, 157 F. 836; since when it has been generally understood that *bankruptcy does not touch the power of a pledgee of shares of stock to close out his collateral. Nothing would be more disturbing to transactions of the kind than a doubt thrown upon that ruling. Millions of dollars are daily lent upon like collateral, which fluctuates from hour to hour; unless the pledgee*

> *is free to choose his time to sell, his security may disappear.* The same is not, indeed true of shares like those at bar, or of notes, neither of which vary rapidly in value; but the same legal reasons exist as to them also. The pledgee, having taken possession of the documents, supposes himself for just that reason to be the sole judge of his necessities, and lends on that understanding. So long as he keeps within the terms of the agreement, he need not concern himself with the pledgor's fate, or that of his creditors, who must stand in his shoes. (Italics supplied.)

In the above case, a trustee in bankruptcy sought to enjoin a holder of collateralized notes of a bankrupt from selling collateral held by him, consisting of notes and stock of another company. The trustee did not allege that the pledge was invalid or that the pledgee was not proceeding in accordance with the agreement, but alleged that "a sale at that time would result in great sacrifice of collateral, which was amply sufficient to protect the loans; that some of the securities were essential to the conduct of the business; and that a reorganization was in contemplation at which all its property would be sold." The Circuit Court of Appeals affirmed the order denying the injunction.

To the same effect are the cases of *In re Mertens*, 144 Fed. 818, and *In re Mayer*, 157 Fed. 836, decided by the same court. These decisions are in accord with the rule followed in *Hiscock* v. *Varick Bank of New York*, 206 U. S. 28. In that case this Court reviewed the order of a referee in bankruptcy disal-

lowing a claim filed by a secured creditor who had sold his collateral consisting of insurance policies. The referee had ruled that the sale held without any court order was void and refused to allow the claim. This Court in affirming the order of the Circuit Court of Appeals reversing the order of the District Court, which in effect had sustained the referee's order, said (page 41):

> When the petition in the present case was filed the bank had a valid lien upon these policies for the payment of its debt. The contracts under which they were pledged were valid and enforceable under the laws of New York where the debt was incurred and the lien created. The bankruptcy act did not attempt by any of its provisions to deprive a lienor of any remedy which the law of the State vested him with; on the other hand, it provided, Sec. 67 (d): "Liens given or accepted in good faith and not in contemplation of or in fraud upon this act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this act."

Hiscock v. *Varick Bank of New York, supra,* is authority for the proposition that under Section 57(h) of the Bankruptcy Act a secured creditor has an absolute right to exercise the power of sale contained in the contract of pledge, and may not be compelled by the Bankruptcy Court to resort to the alternative provision for an appraisal contained in Section 57 (h).

In the case of *In re Browne,* 104 Fed. 762, receivers in bankruptcy sought an injunction restrain-

ing creditors holding promissory notes secured by the pledge of wool from selling the wool. The court in denying the petition of the receivers said (page 762):

> I do not pass upon the question, whether the court may interfere to prevent a fraudulent or oppressive exercise of such a right. No such exercise is threatened in the present case. It is agreed that the creditors intend to deal fairly with the property pledged, and will make an honest effort to sell for the best prices that can be obtained. *This being so, I am of opinion that the bankrupt act gives the court no authority to intervene between these creditors and their exercise of the right to sell given by the collateral notes.* * * * (Italics supplied.)

(ii) Even where the pledged collateral consists of *secured* treasury obligations of the insolvent debtor itself (such as the $7,575,000 of the debtor's first and refunding bonds pledged with the Reconstruction Finance Corporation), the sale of such collateral may not be enjoined.

It is almost uniformly held that a court of bankruptcy has no more power to enjoin the sale of secured obligations of a debtor in the possession of a pledgee than it possesses in the case of obligations of corporations other than the debtor.

In *Jerome* v. *McCarter*, 94 U. S. 734, 739, which has never been questioned, limited, or criticized by any later decision, this Court said with regard to the right of a pledgee to sell secured obligations of the pledgor:

There is some proof that, when the company became bankrupt (Aug. 28, 1872), some of the bonds were held as collaterals for loans made to the company smaller in amount than the bonds pledged. But the bonds were subsequently sold by the pledgees, and the present holders hold them by absolute right. The position that the pledgees could not sell the pledge after the adjudication in bankruptcy, is quite untenable. It is sustained by nothing in the Bankrupt Act. The bonds were negotiable instruments. They passed by delivery, and even were there no expressed stipulation in the contracts of pledge, that the pledgee might sell on default of the pledgor, such a right is presumable from the nature of the transaction. *Certainly the Bankrupt Act has taken away no right from a pledgee secured to him by his contract.*

In regard to the bonds covered by the McCarter mortgage, which is the one now in suit, we find no error in the decree of which the appellants can complain. Most of those bonds, though at first issued as collateral for loans made to the mortgagors, have been sold, and they are now owned by the purchasers. There are some, it is true, that are still held in pledge; but the pledgees have a clear right to use them, either by sale or by collection, until the full amount of the debts due from the mortgagors is satisfied. * * * (Italics supplied.)

In *Guaranty Trust Company of New York* v. *Galveston City Railway Company*, 87 Fed. 813, it appeared that the railway company had borrowed

$50,000 from the bank, executing its demand note therefor and depositing as collateral security $75,000 face amount of its own 6% second-mortgage bonds. The note provided for sale by the pledgee without notice, at public or private sale, the pledgee having the right to purchase the bonds at such sale. After notice and demand for payment, the railway company filed a petition to restrain the bank from selling the bonds. The petition was filed in a foreclosure and receivership proceeding involving a prior issue of mortgage bonds. The railway alleged irreparable injury should the bank sell the secured collateral held by it. The Circuit Court of Appeals reversed the order granting the injunction and remanded the cause with instructions to dismiss the petition. The court, referring to the secured collateral, said (p. 815):

> They are evidence of debt, not assets of the appellee. They have never been assets of the Galveston City Railroad Company. The right of appellant to sell the bonds pledged under the terms of the contract, and the powers confirmed by the terms of the pledge, were not in any way affected by the appointment of a receiver; nor were the position, character, or rights of the parties modified by the allegation that the appellants were the holders of the majority of the first-mortgage bonds. The bonds may change hands; the trustee may be changed for cause; *the receivership may extend for years. When, it might be asked, shall the appellant be permitted to realize on its collateral?* (Italics supplied.)

In re Ironclad Manufacturing Company, 192 Fed. 318, squarely upholds the right of a pledgee of secured collateral of the debtor to realize upon the same by a sale after bankruptcy. The facts in this case were that the bankrupt, Ironclad Manufacturing Company, prior to bankruptcy, borrowed various sums of money upon its own mortgage bonds as collateral. A petition was filed with the District Court to restrain the sale, after bankruptcy, of these secured bonds by the creditors holding them. Both the District Court and the Circuit Court of Appeals decided that the injunction could not issue upon authority of *Jerome* v. *McCarter, supra*. Upon a petition for a stay pending the appeal, Ward, Circuit Judge, stated that if he had the power to grant the stay he would nevertheless deny it "because in the absence of fraud the court has no right to interfere with the exercise of their legal rights as to collateral by pledgees." *In re Ironclad Manufacturing Company, supra*, at 319.

The next case involving this question was *Turner* v. *Metropolitan Trust Company*, 207 Fed. 495. To secure its $600,000 note to a creditor on account of money borrowed, the Western Steel Corporation, bankrupt, had pledged its own mortgage bonds in the amount of $2,000,000. After default in payment of the note the creditor sold the bonds at a private sale and purchased them itself for $25,000. It was held that the creditor was entitled to prove his claim in the bankruptcy proceeding for the amount of the unpaid balance on the $600,000 note and also to prove

$2,000,000 face amount of bonds against the bankrupt estate. The court said (pp. 499–500):

> The attempt to make a distinction between the rule which governs contracts of pledge, where the pledgor prefers to pledge its own mortgage bonds as collateral, and that which governs such contracts, where the pledgor pledges the bonds of another corporation, is not well founded. The contract measures the rights of the parties; and where the expressed intention is that in case of foreclosure the bonds deposited may be sold as existing securities, and the pledgee is given the right to become the purchaser, why should there be any less good title conveyed to such purchaser than if he were selling the bonds of another corporation? The reason for permitting the pledgee to become a purchaser is to permit him to buy the bonds, if he should wish to do so, at a price higher than any one else will pay for them.

The purchaser of the collateral in this case was the pledgee himself. No point was made in the case that the pledged bonds were sold prior to the filing of the petition in bankruptcy. The case is authority that the pledge by a corporation of its own secured obligations stands on exactly the same footing as a pledge of secured obligations of some other obligor.

In *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475, the court considering a similar question, denied a motion for an injunction to restrain the creditor from selling mortgage bonds of the defendant held as collateral. The court said (pp. 476–477):

(1) The answer to the question involved in this motion is thus seen to be dependent upon the answer to the other question of whether a debtor may pledge one promise to pay as collateral for another, thereby putting it within the asserted possible power of the creditor to double the indebtedness. In its concrete form, applied to the facts of this case, the question is: May a debtor pledge his own mortgage bond as collateral for his debt? The question has been authoritatively answered in the affirmative. *Turner* v. *Metropolitan Trust Co.*, 207 Fed. 495, 125 C. C. A. 157. Having the right to receive and hold such a pledge, with the power to sell, the right to exercise the power follows. *Jerome* v. *McCarter*, 94 U. S. 734, 24 L. Ed. 136.

(2) The argument that, because the mortgaged premises are in the hands of the court, the bonds cannot be sold, does not meet the point. The principle is wholly different. No court would permit its possession and control of property under its care to be disturbed; but, although the court has possession of the mortgaged premises, it has not of the bonds. The control pivots on the possession.

Only one case, *Mississippi Valley Trust Co.* v. *Railway Steel Spring Co.*, 258 Fed. 346, so far as we can ascertain, is authority against the rule applied in the foregoing cases. This was an equity proceeding in which the court affirmed an order restraining the pledgee from selling bonds of the defendant pledged as collateral for a loan. The court said (p. 351):

The validity of the transaction by which the trust company became the holder of the

> bonds in question as security for the note which it held of the railway company, and the status of the trust company as such holder, are to be determined by the local law, that is, of the state of Missouri, inasmuch as the transaction was a Missouri transaction (citing cases).

Under the law of Missouri as expounded in *Dibert* v. *D'Arcy*, 248 Mo. 617, unissued bonds, such as were involved in the *Mississippi Valley Trust Co.* case, were held not to have been put into circulation and not to constitute a personal liability of the corporation. Their only effect, under the Missouri law, was that the pledgee became the holder of them for the purpose of enforcing his lien. Under Missouri law, then, the bonds were not the personal obligations of the debtor in the hands of the pledgee, but might become so if negotiated to a bona fide holder.

If the issue in this case is to depend on local law, then, as to this petitioner, the law of the State of New York will govern because, as shown by Exhibit A to the debtor's petition for the injunction (R. 45), the notes of petitioner were made and are payable in the State of New York. The *Ironclad Manufacturing Co.* case, *supra*, leaves no doubt that the Missouri rule does not prevail in New York.

The overwhelming weight of authority, as seen, is contrary to the rule announced in the *Mississippi Valley Trust Co.* case.

(iii) Where the pledged collateral consists of *unsecured* treasury obligations of the insolvent debtor

itself (neither the Reconstruction Finance Corporation nor the banks in this case hold any pledged obligations of this sort), it has been held that the Court may enjoin the sale of such obligations on the theory that the collateral consists merely of a multiplication of the number of promises to pay the same debt.

The leading case in favor of the above proposition is *John Matthews, Inc.*, v. *Knickerbocker Trust Co.*, 192 Fed. 557. The decision indicates clearly that the Circuit Court of Appeals would have decided the case differently, had the collateral been *secured* obligations of the same debtor.

This would appear from the following extract from the court's opinion (p. 558):

> The debenture bonds of the bankrupt corporation which the petitioner holds as collateral do not purport to impose any lien or charge upon the property of the corporation and are nothing more than instruments importing an obligation to pay. * * * The real debt which the bankrupt corporation owed the petitioner was evidenced by the note, and nothing more was added to it by giving as collateral another promise to pay. Any rule which would permit the proof of two notes for one indebtedness would permit the proof of a dozen, and would substitute for pro rata distribution among real creditors, distribution in accordance with the ability of a bankrupt to make manifold obligations for single debts.

The rule here laid down has no application to this case, since none of the collateral held by the Recon-

struction Finance Corporation or the banks consists of *unsecured* treasury obligations of the debtor.[3]

It is clear that, apart from Section 77, where the pledged collateral consists of secured obligations of the debtor or of corporations other than the debtor, validly

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[3] Other cases involving *unsecured* treasury obligations of the same debtor have gone on the theory that such unsecured obligations do not in institutional practice constitute "collateral." See *Shoemaker* v. *Nat. Mechanics Bank.*, 21 Fed. Cas. No. 12801, 1331, 1334, where the following statement is made: "* * * collateral security in bank phraseology means some security additional to the personal obligation of the borrower." Such would seem to be the general understanding and the meaning of the term. See 2 Words and Phrases (First Series) pp. 1252, 1253. See also *In re Waddell-Entz Co.*, 67 Conn. 324, 335, where it is stated: "A debtor's additional promises to pay [unsecured notes] cannot, from the very nature of the case, be treated as collateral security for his debt, unless such additional promises are themselves secured by a lien on property or by the obligations of third persons; under such circumstances they may be treated as collateral security so far as is necessary to obtain the benefit of the lien or obligation. This self-evident proposition has rarely been discussed in reported cases. The principle, however, has been clearly stated by the courts of New York and Massachusetts. *People* v. *Remington*, 54 Hun, 480, affirmed, 121 N. Y. 675; *Third Nat. Bank* v. *Eastern R. R. Co.*, 122 Mass. 240; * * *

"* * * Whether or not they [unsecured notes] might constitute a debt for their face value in the hands of a third party * * * would depend upon the circumstances of such purchase. Their standing, in such case, as a debt against the insolvent estate, would not depend on their sale as 'collateral security,' but on their valid assignment to an innocent third party." (Words in brackets supplied.)

To the same effect see *Jones* v. *Third Nat. Bank*, 13 F. (2d) 86; *Union Nat. Bank* v. *People's Savings & Trust Co.*, 28 F. (2d) 326.

pledged and in the possession of the pledgee, a bankruptcy court, under any provision of the Bankruptcy Act here applicable, may not restrain the latter from selling the same, pursuant to the terms of the pledge contract, whether or not the sale requires judicial proceedings.

B. *The well-settled law in these respects has not been changed by the enactment of Section 77*

(i) The ordinary canons of statutory construction, when applied to the express provisions of Section 77, refute the implication of an intent to change the established rules of law

The 1933 amendments to the Bankruptcy Act contain no express provisions abrogating the rule of law in ordinary bankruptcy proceedings. If such power exists, then, it must be because it can be implied. But it is a well-established canon of statutory construction that an amendment by implication can occur only where the terms of the later statute are so repugnant to an earlier statute that they cannot stand together. This elementary canon of statutory construction is applicable to the construction of Section 77, particularly in view the language of subdivision (n) thereof, which reads as follows:

> In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had

> been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed.

The Circuit Court of Appeals affirmed the order of the lower court on the ground that the power to issue the injunctional order under review could be implied as an incident to other powers expressly conferred by Section 77 (R. 32[illegible]).

The issuance of an injunction such as the one under review in this case is an extreme and unprecedented invasion of the rights of creditors holding collateral. It is, indeed, difficult to believe that the Congress would not have *expressly* conferred upon the court the power to issue such an injunction had it been the intent of the Congress to grant the power.

The only provision in Section 77 relative to injunctions is contained in subdivision (1) of Section 77, reading as follows:

> (1) In addition to the provisions of section 11 of this Act for the staying of pending suits against the debtor, such suits shall be further stayed until after final decree [and] the judge may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree.[4]

There is no other provision of Section 77 which in any way confers upon the court the power to enjoin a secured creditor such as the Reconstruction Finance

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[4] The word in brackets was apparently omitted from the statute by inadvertence, since otherwise the sentence construction is defective.

Corporation from selling pledged securities pursuant to the terms of the pledge contract, where judicial proceedings are not required. To say that the power to issue such an injunction may be implied as an "incident" to powers expressly conferred by Section 77 is judicial legislation.

It is to be noted that subdivision (1) of Section 77, above set forth, grants power only to stay a *judicial proceeding* to enforce a lien.[5]

Under the well-established canon of statutory construction. *"Expresio unius est exclusio alterius"*, applied to the jurisdiction of courts in *In re Heath*, 144 U. S. 92, 93, where this Court said: "* * * that the affirmative description of the cases in which the jurisdiction may be exercised implies a negative on the exercise of such power in other cases * * *", the power in the court to enjoin secured creditors from enforcing against collateral the terms of the pledge agreement is clearly negatived by the statute.

The general rule applicable is stated as follows by Ruling Case Law (25 R. C. L. 981, section 229):

> It is a general principle of interpretation that the mention of one thing implies the exclusion of another thing; *expressio unius est exclusio*

[5] It is suggested that in using the words "judicial proceedings" in subdivision (l) of Section 77, Congress may have had in mind a narrow purpose, viz., to authorize a Federal bankruptcy court to enjoin the foreclosure in State courts of "liens upon the estate" of the debtor. Without subdivision (l) or similar express authority the injunction of certain State proceedings by the Federal court would be prohibited by Sec. 265 of the Judicial Code, 28 U. S. C. A., Sec. 379.

alterius. The affirmative description of the cases in which the jurisdiction may be exercised implies a negative on the exercise of such power in other cases.

Had the Congress intended that enforcement of the terms of the pledge agreement against collateral might be enjoined in cases where judicial proceedings were not necessary to aid in such enforcement, it would have been a simple matter to add to subdivision (1) a provision expressly so providing. The significant thing is that the Congress did not do so.

(ii) The construction adopted by the Circuit Court of Appeals does not give effect to the express words of Section 77.

The construction adopted by the Circuit Court of Appeals gives no effect to the words "commencement or continuance of any judicial proceeding" contained in subdivision (1) of Section 77. The court construes Section 77 *exactly as if these words were omitted* and as if the Act provided that the court might enjoin the "enforcement of any lien upon the trust estate."

In accordance with the accepted rule of statutory construction that effect must be given to the express words of a statute, the words "commencement or continuance of any judicial proceeding" must constitute a limitation on the power of the court to enjoin the enforcement of liens.

From the wording used it would appear that, in drafting subdivision (1), the Congress was providing for injunctions to prevent the enforcement of liens upon the trust estate. In providing that "the

commencement or continuance of any judicial proceeding" might be enjoined the Congress clearly marked off the limits of the power.

(iii) Subdivision (1) of section 77, furthermore, is applicable only to judicial proceedings to enforce "any lien." A pledgee of negotiable securities has a greater interest therein than a mere "lien."

Subsection (1) of Section 77 gives the bankruptcy court power to enjoin "any judicial proceeding to enforce *any lien upon the estate*". Even if the argument that subsection (1) only gives power to enjoin "*judicial*" proceedings should fail, there is a serious question whether the interest or claim of the Reconstruction Finance Corporation to the collateral securities held by it can be said to be merely a "*lien.*" The bonds held by the Reconstruction Finance Corporation, being corporate railroad obligations, are undoubtedly negotiable instruments payable to bearer, and, upon their transfer to this petitioner, title thereto would, under the provisions of the Uniform Negotiable Instruments Law, become vested in Reconstruction Finance Corporation even though the transfer was made to it as pledgee. As between the Reconstruction Finance Corporation and the debtor, complete title might be said, under the authorities, not to have passed to the Reconstruction Finance Corporation, yet under many authorities a special title or property, which enjoys a legal status paramount to that of a mere lien, has vested in the Reconstruction Finance Corporation.

The Reconstruction Finance Corporation believes that the "*lien*" referred to in the Act is a lien created by contract upon tangible properties in the possession of the debtor, actual or constructive, at the commencement of the proceeding, and that the term was not intended to apply to choses in action, such as the bonds in the present case, which had previously been delivered in pledge. Furthermore, if the title to the pledged securities can be said to have vested in the Reconstruction Finance Corporation at the time of the transfer of the same to them, it may well be questioned whether such securities constitute "the estate" of the debtor within the meaning of Section 77. An informative discussion upon these questions appears in the opinion of the Circuit Court of Appeals in *In re Hudson River Nav. Corporation*, 57 F. (2d) 175, where Judge Learned Hand said (p. 175):

> The case presents a difficulty we have before discussed (*In re Roman* (C.C.A.) 23 F. (2d) 556; *In re Borok* (C. C. A.) 50 F. (2d) 75); that of applying to choses in action notions drawn from the law of chattels, more particularly of deciding whom we shall say to be in "possession" of such property. As to both notes (section 79 Negotiable Instruments Law [Consol. Laws N. Y. C. 38]), and shares (section 162 (b), Personal Property Law [Consol. Laws N. Y. c. 41]), delivery of the documents under a written assignment transfers "title", when the transfer is absolute; and by "title", we understand that the assignee becomes the obligee. Though these transfers were in

> pledge, it would seem that *pro tanto* the sections might convey to the pledgee his "special property," whatever that may be, though so far as we can find the case has not arisen. But as the question does not turn upon "title" but "possession," the difficulty still remains. It seems to us unnecessary to refine too far; in substance, entire control over the obligation passes to the pledgee, who certainly gets possession of the documents, without which, so long as the pledgee acts in accord with the agreement, the pledgor cannot assert any rights as obligee. For practical purposes the pledgee has therefore immediate dominion as between the two, and with it goes the power to resist any action by the bankruptcy court, which must be founded on the fact that the bankrupt had such dominion, when the petition was filed. This was implicit in our ruling in *In re Mertens*, 144 F. 818, and we directly held so in *In re Mayer*, 157 F. 836.

In *National Bank* v. *American Brewing Co.*, 257 Pac. (Mont.) 1043, the court said at page 1046:

> The transfer before maturity of a negotiable promissory note in pledge vests an absolute title in the pledgee, irrevocable except upon the payment of the principal indebtedness. *Yellowstone National Bank* v. *Gagnon*, 19 Mont. 402, 48 P. 762, 44 L. R. A. 243, 61 Am. St. Rep. 520; *First National Bank of Lewistown* v. *Wilson*, 57 Mont. 384, 188 P. 371; *French & Co.* v. *Haltenhoff*, 73 Or. 249, 144 P. 480.

In *Winnemucca State Bank & Trust Co.* v. *Corbeil*, 178 Pac. (Nev.) 23, the court said at page 25:

> And the plaintiff, by taking the note expressly as a collateral security, undertook to account to the insurance company for the property assigned. It became the holder of the legal title under an express trust to hold the beneficial interest or the money collected primarily for itself, and secondarily for the indorser.

That the pledgee receives either absolute title or a special title or interest which is more than a mere lien is also shown by the following decisions:

Thomson v. *Findlater Hardware Co.*, 156 S. W. (Tex.) 301;

Leonard v. *Taylor*, 39 S. W. (2d) (Ark.) 704;

Fox v. *Harrison National Bank*, 50 Pac. (Kan.) 458;

American National Bank v. *Tarpley*, 250 Pac. (N. Mex.) 18;

Dickey v. *Pocomoke City National Bank*, 43 Atl. (Md.) 33;

Dulin v. *National City Bank*, 130 N. E. (Ind.) 426;

Goodman v. *Simonds*, 20 How. 343;

N. Y. Marbled Iron Works v. *Smith*, 4 Duer (N. Y.) 362;

Murray v. *Lardner*, 2 Wall. 110;

Railroad Co. v. *National Bank*, 102 U. S. 14.

In *In re Parmenter*, 70 F. (2d) 929, the court said at page 936:

> So far as we know it has always been held that a bankrputcy court has no jurisdiction whatever over pledged security which has been transferred in good faith by a debtor to his creditor more than four months prior to the filing of the bankruptcy petition. . .

See also the following recent cases arising under Section 74 or 75 of the Bankruptcy Act: *In re Hillmert* (C. C. A. 7th, 1934), 71 F. (2d) 411; *Molina v. Murphy* (C. C. A. 1st, 1934), 71 F. (2d) 605; *In re Smith* (E. D. Ill., 1934), 7 F. Supp. 863, 864.

(iv) Section 74, enacted as part of the same Act containing section 77, has been construed not to authorize a bankruptcy court to enjoin the sale of pledged collateral.

Chapter VIII of the Acts of Congress relating to Bankruptcy (47 Stat. 1467; 11 U. S. C. A. Sections 201–205) was enacted as one Act pursuant to a general policy of Congress. While Section 77 of this Act deals with railroads, Section 74 applies to persons other than corporations.

A provision somewhat similar to subdivision (1) of Section 77 is found in subdivision (n) of Section 74. Subdivision (n) of Section 74 has been construed by Judge William Bondy of the District Court for the Southern District of New York in *In re Doelger*. In this case, on a motion made by the holder of a collateralized note for an order vacating an injunction, insofar as it enjoined the sale of the collateral security, the court in an unreported decision handed down on

May 13, 1933 (9 American Bankruptcy Rev. 329, June 1933), said:

> This motion is made in a proceeding brought under section 74 of the Bankruptcy Act, enacted March 3, 1933, and entitled "Provisions for the Relief of Debtors", to obtain an extension of time for payment of the debts of petitioner. The question presented is whether the new act affects the creditor's freedom of recourse to the security pledged, and particularly whether the court is authorized to enjoin a sale of such security.
>
> Subdivision (h) of section 74 (11 U. S. C. A., sec. 202) provides: "The terms of an extension proposal may extend the time of payment of either or both unsecured debts and secured debts the security for which is in the actual or constructive possession of the debtor or of the custodian or receiver. * * *" Subdivision (n) provides: "In addition to the provisions of section 11 of this act for the staying of pending suits, the court, on such notice and on such terms, if any, as it deems fair and equitable, may enjoin secured creditors who may be affected by the extension proposal from proceeding in any court for the enforcement of their claims until the extension has been confirmed or denied by the court."
>
> Under these express provisions it seems clear that the court's power to enjoin is restricted to court proceedings; and that an extension may be obtained only of secured debts the security for which is in the actual or constructive possession of the debtor, a custodian, or receiver. Neither of these conditions is applicable to the creditor here involved.

See, to the same effect, the decision of a referee in bankruptcy in *In the Matter of H. F. Chaiken*, (C. C. M. D. Pa.) 10 Am. Bky. Rev. 14, 16, Aug. 1933.

(v) The legislative history of Sections 74 and 77, passed at the same time, discloses that the Congress did not intend to grant to the courts any greater power to restrain sales of collateral than they previously possessed.

While there is no ambiguity in Section 77 on the questions here presented, it is well settled that, where ambiguity exists, committee reports and the statements on the floor of Congress in explanation of the Act by those in charge of its passage are admissible to show the intention of Congress.

In *United States* v. *Great Northern Ry.*, 287 U. S. 144, this Court held and said (pp. 154, 155):

> Thus far we have not traveled, in our search for the meaning of the law-makers, beyond the borders of the statute. In aid of the process of construction we are at liberty, if the meaning be uncertain, to have recourse to the legislative history of the measure and the statements by those in charge of it during its consideration by the Congress. *United States* v. *Missouri Pacific R. Co.*, 278 U. S. 269, 278.

See also *Duplex Co.* v. *Deering*, 254 U. S. 443, 474, 475.

Assuming (but not conceding) that there is ambiguity in Section 77 on the points at issue, the legislative history of certain subdivisions of Section 74 pointed out in the extract from the opinion in *In re*

Doelger, already quoted, leaves no doubt that the Congress was fully cognizant of the distinction between a secured creditor in possession of his security and one not in possession, and, that the final intent of the Congress was that the court's power under Section 74 to enjoin sales of collateral in a creditor's possession should be restricted to court proceedings.

Not only was Section 74 of the bill amended in the Senate to protect pledgees in possession of their security, as is pointed out in the dicision of Judge Bondy, but subdivision (n) of Section 77 guaranteeing to creditors that so far as consistent with the other provisions of the bill their rights should be the same as under the old act was added to the bill after it had passed the House. (Bill in House, 76 Cong. Rec. 2905, 2906; Bill introduced in Senate with present subsection (n) added, 76 Cong. Rec. 4907, 4909.)

The Senate Committee filed no written report with respect to Section 77. However, a report was prepared as to Section 74 (Report of the Senate Committee on the Judiciary (Report No. 1215, 72d Cong., 2d sess.)) which explained the change in that section as follows (p. 5):

> It will be observed that section (h) of the House bill in this respect has been modified so that it applies only to "secured debts, the security for which is in the actual or constructive possession of the debtor or of the custodian or receiver." It was believed that if every form of collateral that was deposited as a security for a loan should be subject to review by the court in any proceedings under this

> act that it could but result in a greater value of collateral being required by the person or institution granting the loan in the first instance. The tendency would be to further restrict credit.

It is of some significance that in the "Criticisms and Suggestions Relating to H. R. 14359 and S. 5551, amending the bankruptcy act", at p. 95 (printed in 1933 for use of the Senate Committee on the Judiciary, 72d Cong., 2d sess.), there is printed at least one proposed plan for railroad reorganizations which expressly includes the right to enjoin pledgees from converting their security. This suggestion was rejected by the committee, and subdivision (n), to the opposite effect, added.

That the Congress did not intend to interfere with the right of any creditor, and particularly, the Reconstruction Finance Corporation, to sell the security in its possession is borne out by the discussion which occurred on the floor of Congress. This appears in part from the following answer by Mr. Sumners of Texas, who was sponsoring the bill in the House, to a question on this point (76 Cong. Rec. 2909):

> Mr. GARBER. What will be the preferential status given loans made by the government to the railroads, over investments in stock and bonds?
>
> Mr. SUMNERS. They are not given by this bill any preferred status which they do not now have and to whatever degree now preferred the status is not lessened. They are not disturbed.

To the same effect is the following discussion which occurred in the House at the time when the House voted to concur in the Senate amendments (76 Cong. Rec. 5359):

> Mr. GARBER. The Government has loaned to the railroads $350,000,000 or more. What protection does this bill give the Government?
>
> Mr. PARKER of New York. It protects the Government just as much as the Government is protected now, no more and no less.

The members of the Congress were thus concerned whether the security underlying some $350,000,000 of public money loaned to the railroads by the Reconstruction Finance Corporation would be impaired by the passage of the act. In enacting Section 77 there was no intent to limit the express powers of the Reconstruction Finance Corporation, or to empower the courts to prevent it from selling its collateral by injunction.[6]

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[6] The following appear to be the major objectives which the Congress sought to achieve by Section 77:

(1) The expense, delay, and inconvenience of numerous ancillary receiverships in other districts and jurisdictions were to be eliminated (76 Cong. Rec. 2787-2788; 4880; 5106-5107; House Judiciary Committee Report on H. R. 14359 (Report No. 1897) p. 5; Joint Hearings before Subcommittee of the Committees on the Judiciary on S. 3866 (a prior bill), p. 519.)

(2) The excessive fees sometimes allowed to attorneys, reorganization managers, and bondholders' committee members were to be reduced and fixed within limits to be set by the Interstate Commerce Commission (76 Cong. Rec.

(v) Subclause 15 of Section 2 of the Bankruptcy Act when read in connection with the 1933 amendments does not extend the jurisdiction of the Bankruptcy Court so as to permit it to enter the order under review in this case.

Although the Circuit Court of Appeals apparently found the necessary authority to issue the injunction in the 1933 amendments alone, the order of the District Court was based on the assumption that the necessary power came from reading Subclause 15 of Section 2 with Section 77 (R. 104). The same contention was vigorously asserted in the brief filed with this Court by the respondents in opposition to petition for writs of certiorari.

It is a cardinal canon of statutory construction, as was recently said by this Court, in referring to subclause (15) of Section 2 of the Bankruptcy Act in *Ginsberg & Sons.* v. *Popkin*, 285 U. S. 204, 208, that

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2923; 4887; 5106; 5127; 5359. House Judiciary Committee Report on H. R. 14358 (Report No. 1897), p. 5).

(3) Authority was to be conferred upon two-thirds of any class of stockholders or security holders to bind the balance of the class to any plan of reorganization approved as fair by the Interstate Commerce Commission and the court. The Act was to eliminate the hold-up tactics of small minorities having comparatively little at stake, who in the past have insisted upon preferential treatment before they would agree to any plan (76 Cong. Rec. 2785; 4882; 5128. House Judiciary Committee Report on H. R. 14359 (Report No. 1897), p. 7).

(4) Supervision of reorganizations was to be transferred from the committees of the investment banking houses, which in the past often have been accused of bad faith in connection with their control of the reorganization, to the

> General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment. * * *

In the above case subclause (15) of Section 2 was invoked to support a *ne exeat* order of the court, preventing an officer of a bankrupt corporation from leaving the jurisdiction prior to submitting to an examination by the creditors of a bankrupt corporation. It appeared that the distribution of the property of a corporation among the creditors might be defeated in case the order were not entered, since the creditors charged in the petition for the writ that the officer had converted corporate funds to his own use and was planning to leave the country, taking the funds with him. Nevertheless, this Court held (pp. 206, 208):

Interstate Commerce Commission, in order to better protect the public interest. (76 Cong. Rec., 5106–5129.)

Compare, in connection with the foregoing, the following: Rodgers and Groom, *Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act* (1933), 33 Col. L. Rev. 571; Weiner, *Reorganization under Section 77: A Comment* (1933), 33 Col. L. Rev. 834; Lowenthal, *The Railroad Reorganization Act* (1933), 47 Harv. L. Rev. 18; Wehle, *Railroad Reorganization under Section 77 of the Bankruptcy Act: New Legislation Suggested* (1934), 44 Yale L. J. 197; Douglas, *Protective Committees in Railroad Reorganizations* (1934), 47 Harv. L. Rev. 565; Friendly, *The Corporate Reorganizations Act* (1934), 48 Harv. L. Rev. 39, esp. pp. 41–48; Weiner, *Corporate Reorganization: Section 77B of the Bankruptcy Act* (1934), 34 Col. L. Rev. 1173; *Memorandum* of Jan. 31, 1933, by Joseph B. Eastman, Chairman, Legislative Committee, Interstate Commerce Commission, H. R. Rep. 1897, p. 5, 72d Cong., 2d sess. (1933).

> Clause (15) is to be construed having regard to the other parts of Section 2, to the provisions of the Act in respect of examinations concerning the business and property of bankrupts, and to Section 261 of the Judicial Code relating to writs of *ne exeat*
>
> * * * * * * * * there is no support for petitioners' contention that the general language of Section 2 (15) is a limitation upon Section 9 (b) or grants additional authority in respect of arrests of bankrupts.

Since the question of injunctions against the enforcement of liens on property of the debtor is specifically covered by subdivision (1) of Section 77, section 2 clause (15) may not be relied upon to change or broaden its provisions.

The rights of parties holding valid bona fide liens are similarly expressly protected by Section 67 (d); and the right of secured creditors to sell their securities pursuant to the terms of the pledge is expressly guaranteed by Section 57 (h), as construed by this Court in the case of *Hiscock* v. *Varick Bank of N. Y.*, 206 U. S. 28.

It would seem that no room was left for interpretation or for the application of Section 15 clause (2) of the Bankruptcy Act, since it may not be invoked to vary or broaden other provisions of the Bankruptcy Statute. That Section 2 (15) does not confer upon the District Court power to issue the injunction would seem necessarily to follow from the fact that that section has never in the past been construed to

authorize a bankruptcy court to restrain the sale of pledged collateral. The holding of the District Court for the Eastern District of Pennsylvania in *In re Browne*, 104 Fed. 762, in which the court had occasion to consider an application by a receiver in bankruptcy to make permanent a temporary order restraining the sale of wool pledged to secure promissory notes of the bankrupt may appropriately be quoted in this connection (p. 763):

> Clause 7 of section 2, giving the court power to "cause the assets of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided", *and clause 15 of the same section, giving power to "make such orders, issue such process and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this act", must, of course, be read in connection with the rest of the statute, and are necessarily qualified by such provisions as are to be found in clause "d" of section 67, concerning liens, and by clause "h" of section 57, concerning the method of ascertaining the value of securities held by the creditors.*
>
> In each case the restraining order is now dissolved, and the petition of the receivers is refused. (Italics supplied.)

A change so highly disturbing to existing arrangements and practices in railroad finance as that contended for by the respondents in this case must be found in plain terms. This Court will not be astute

to infer a legislative purpose to unsettle the general principles of law unless there is *express* verbal basis therefor in the Act itself. Such basis does not exist in Section 77.

C. *Section 77 and Section 2 (15) must be construed with Section 5 of the Reconstruction Finance Corporation Act, which expressly empowers the Reconstruction Finance Corporation to take over and liquidate collateral accepted by it as security for certain loans.*

(i) Applicable provisions of the Reconstruction Finance Corporation Act.

Section 5 of the Reconstruction Finance Corporation Act of January 22, 1932 (c. 8, 47 Stat. 5) provides for loans by the Corporation to aid in financing agriculture, industry, and commerce. Loans may be made under this Section "to aid in the temporary financing of railroads and railways engaged in interstate commerce"; such loans are required by the same section to be "fully and adequately secured." Included within these provisions are loans by the Reconstruction Finance Corporation to the debtor involved in this case.[7] Under the terms of Section 5, approval of the Interstate Commerce Commission is made a condition precedent to the granting of such loans. The Commission may require of the borrowing railroad that it comply with such conditions as to security and otherwise as the Commission may see fit to impose. The Board of Directors of the Reconstruction Finance Corporation is required to find, in

[7] See Appendix, pp. 5, 59, 80.

the case of each such loan, not only that the loan will be adequately secured, but also that the railroad is unable to obtain funds upon reasonable terms through banking channels or from the general public.[8]

These provisions as to adequacy of security are supplemented by the provision contained in Section 5, applicable to all loans made thereunder,[9] set forth as follows:

> The corporation (the Reconstruction Finance Corporation), under such conditions as it shall prescribe, *may take over or provide for the administration and liquidation of any collateral accepted by it as security for such loans.*[10] (Parentheses and italics ours.)

(ii) *These statutory provisions when construed in connection with Section 77 are controlling.*

The statutory provisions applicable to loans to railroads, enacted by the same Congress as enacted the amendment to the Bankruptcy Act, must be

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[8] See Appendix, p. 3.

[9] As of December 31, 1934, Reconstruction Finance Corporation had disbursed a total of $3,365,136,707.11 on loans made under this Section to all classes of borrowers. If the construction of Section 77, adopted by the Circuit Court of Appeals, is used as a precedent under Section 77 B, the adequacy of the collateral taken for some of these loans (in addition to the railroad loans) is likewise subject to question, in cases where the borrowers are companies which are permitted by the terms of Section 77 B to file a petition thereunder.

[10] This provision likewise applies to any loans which may be granted under subdivision (f) of Section 20, Title II of the Emergency Relief and Construction Act of July 1932, 47 Stat. 709. (Appendix, p. 3.)

construed in *pari materia* with the provisions of Section 77. The contention that the express grant of power to the Reconstruction Finance Corporation to take over and provide for the administration and liquidation of collateral was qualified by the later enactment of Section 77 must be rejected for the following reasons:

(a) Congress, having expressly granted such power, may not be presumed to have conferred an empty prerogative. Rather must it be presumed that the power was granted in order that it might be used by the Reconstruction Finance Corporation, when, in the judgment of the Corporation, the taking over and liquidation of any collateral accepted by it might be necessary or deemed advisable to prevent a loss of public funds. The exercise of this power prior to the appointment of receivers or trustees is unlikely, since it would precipitate a hasty liquidation of assets which is, of course, contrary to the main purpose for which the Reconstruction Finance Corporation was created by the Congress and the Executive. Even less likely would be the exercise of the power to administer collateral in the case of still solvent borrowers since such action would cause a race of diligence among creditors for the calling of loans which would inevitably result in receivership or bankruptcy for the borrower. But if this grant of power to take over and provide for the administration of collateral is to be given any pragmatic effect, consistent with the underlying purposes of the Reconstruction Finance Corporation Act, exercise of the power must

be allowed *after* receivership or bankruptcy has occurred; otherwise the provision is of no practical utility.

(b) Implicit within the Congressional grant of power to the Reconstruction Finance Corporation to take over and liquidate collateral is the privilege without resorting to judicial proceedings, to sell the collateral to others or to buy it in, and to apply the proceeds of the sale against the borrower's indebtedness. Any other interpretation of the words "take over or provide for the administration and liquidation" of collateral held by the Corporation would repudiate the legislative intent of the Congress as evidenced by the debates which accompanied the passage of the act.

We submit, therefore, that this Court should not lay down any rule which will restrict the Reconstruction Finance Corporation in the exercise of a necessary and express power conferred upon it by the Congress.

We have already shown that there is no provision in Section 77 which authorizes the District Court to restrain the holder of collaterally secured notes of a debtor railroad from selling such collateral when a sale does not require judicial proceedings and is expressly authorized by the pledge agreement. We have also shown that on the contrary the provisions of Section 77 negative the implication that the court has such power.

Patently, this is not a case of the reconciliation of an earlier statute with a later enactment containing inconsistent provisions. Any apparent inconsistency

between Section 5 of the Reconstruction Finance Corporation Act [reaffirmed by the Act of January 20, 1934 (c. 3, 48 Stat. 318) enacted after Section 77 (Appendix p. 4)], and Section 77 results from the construction put upon the latter by the courts below. It has been contended before this Court (Brief of respondents in opposition to petitions for writs of certiorari, page 10) that for the source of the District Court's authority to enjoin the Reconstruction Finance Corporation resort must be had to subclause 15 of Section 2 of the Bankruptcy Act (11 U. S. C. A., Sec. 11) as it existed prior to the enactment of Section 77, reading as follows:

> The courts of bankruptcy * * * are invested, within their respective territorial limits * * * with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings * * * (15) make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title;

But this Court should not permit a derivation of power from the so-called omnibus clause, couched in *general* language, to prevail over a power *expressly* granted by the Congress to the Reconstruction Finance Corporation under Section 5 of the Reconstruction Finance Corporation Act, above set forth.

The statutory power of the Reconstruction Finance Corporation to take over and liquidate collateral was not passed upon by the Circuit Court of Appeals.

III

CONSIDERATIONS OF ECONOMIC POLICY DO NOT SUGGEST STRAINING THE SETTLED LAW TO ENLARGE POWER TO ENJOIN PRIVATE SALE OF COLLATERAL; THEY LEAD RATHER TO AN OPPOSITE CONCLUSION. INDEED, SO FAR AS THE RECONSTRUCTION FINANCE CORPORATION IS CONCERNED, THE CONGRESS HAS SANCTIONED THE ECONOMIC POLICY HERE CONCERNED AND HAS SET UP AN ADMINISTRATIVE ECONOMIC CONTROL WHICH RENDERS IT UNDESIRABLE THAT THE ECONOMIC POLICY HERE INVOLVED BE OVERRIDDEN BY THE COURTS.

A. *Enlarging the area of injunctions against sale of private collateral will upset a tremendous volume of railroad finance and will lead to a distortion of the existing situation.*

Economic considerations have been urged as bearing on the issue presented by the instant case.[11] But arguments addressed to the economic field have to proceed on economic grounds. In that area only the result counts; legal distinctions become immaterial. Thus, to the suggestion that the injunction is not against the pledge of collateral, which is substantive, but only against the private sale of collateral to pay the debt, which is remedial,[12] the economist's answer is that it is immaterial where the impossibility is created, if the result is to make the loan impossible.

It is indisputable that an injunction of this nature substantially cuts off the power of a railroad to

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[11] See for example, Hatch, *A Form of Depression Finance—Corporations Pledging Their Own Bonds* (1934), 47 Harv. Law Rev. 1093.

[12] The distinction was made by the Circuit Court of Appeals below (R. 326).

borrow on short-term credit. A loan which can be tied up for an indefinite period is not a liquid loan; therefore it is rarely acceptable to banks, which are at present the principal source of short-term credit.[13]

(i) The economic effect: perpetuating corporate security holdings.

Unfortunately, the economic effect is by no means exhausted when it is said that the use of the short-term loan becomes greatly restricted.

Railroads are always corporations. Substantially all have the power to own and hold securities in other corporations. They frequently hold stocks and bonds of roads which are constituent parts of their system. It is common knowledge that they frequently hold securities of other companies more or less ostensibly incidental to their business: stocks and bonds of connecting lines; stocks of lines which at one time they hoped to control, stocks of land companies and enterprises along their rights-of-way; stocks and bonds of terminal companies. Subsidiary railroads forming a part of the parent system are by no means necessarily logical adjuncts to that system. They may be haphazard acquisitions, historical survivals of past financial struggles, or half-completed enterprises.

A major economic corrective to this concentration is the attrition which becomes possible, when a railroad after pledging its assets, defaults. If this form

[13] Compare, Hardy and Viner (1934), *Report on the Availability of Bank Credit in the Seventh Federal Reserve District.* (Report prepared for United States Treasury Department.)

of securing short-term notes is eliminated, the railroad will tend to go into receivership with this body of assets intact. Rarely has there been substantial dispersion of these assets as a result of reorganization. Rather, they are dealt with so that the railroad's property, including stock and bond interests in other corporations, emerges nearly intact. Almost the only avenue by which they can be dispersed is through direct sale, or sale to pay off collateral loans, and their passage into the hands of a creditor.

Deletion of corporate short-term credit secured by pledge of securities would as likely as not tend merely to perpetuate absurd situations.

Extension of the doctrine set out by the Circuit Court of Appeals would tend indefinitely to perpetuate concentrations of security holdings in corporations. The decision of the Circuit Court of Appeals here under review has already been invoked as authority to justify injunction against the sale of pledged securities by creditors of an industrial corporation in bankruptcy under the provisions of Section 77B—a similar statute applied to nonrailroad corporations. In the case of *In Re White Truck & Transfer Company* (District Court for the Southern District of California, September 14, 1934, not yet officially reported), it was held that the bankruptcy court might restrain a chattel mortgagee from taking possession of chattels in control of the debtor; a similar result was reached with respect to the vendor of property sold under a conditional sales agreement. The doctrine of the instant case was cited as authority.

We would ask the Court to consider the effect of this doctrine as applied to a so-called "investment trust" corporation, or a "grab-bag" public utility holding company. The effect on commercial processes in general, and on the perpetuation of corporate structures, is material.

The results of sustaining the injunction are almost unpredictable. It is reported that approximately 200 cases of reorganization under Section 77B are already pending in the District Court for the Southern District of New York alone; 357 cases in Chicago. If this doctrine becomes general the economic aftermath will of necessity be grave.

(ii) There is likewise an economic reason for the practice of pledge by a railroad of its own obligations held in its treasury: without this facility, it may be at the mercy of the stock market or of investment banking, or both.

The pledge of a railroad's own mortgage bonds as security for a loan is not anomalous. The use of the mortgage bond as a security device is associated historically with the development of the American railroad.[14] Frequently the railroad's only method of

[14] See, generally, Ripley, *Railroads: Finance and Organization* (1915) 143; Dewing, *Corporation Securities* (1934) 263, 276-278; Mitchell, *The Collateral Trust Mortgage in Railway Financ* (1906) 20; Cleveland and Powell, *Railway Finance* (1912) 47-49; 20 *Quarterly Journal Economies* 443.

Compare, *James* v. *Railroad Co.*, 6 Wall 752. (1867); *Androscoggin R. R. Co.* v. *Auburn Bank*, 48 Me. 335 (1861); *Morris Canal & Banking Co.* v. *Fisher*, 9 N. J. Eq. 667 (1855); *Morris Canal & Banking Co.* v. *Lewis*, 12 N. J. Eq. 323 (1858); *Curtis* v. *Leavitt*, 15 N. Y. 9 (1857); *Jesup* v. *City Bank*, 14 Wis. 331 (1861).

anticipating known cash income was through pledge of its long-term obligations which had acquired a known liquidity and market price; yet permanent increase of its bonded debt was plainly undesirable. The bonds of its subsidiary or constituent corporations which had no similar open-market status, could be given such status when placed behind a direct obligation of the railroad (as by a collateral trust issue); and such issues have frequently been created principally for the purpose of providing an avenue of short-term financing where possible, as well as of long-term financing when necessary.

When bond issues can be brought out in the open market only at a serious discount from face value, or when the market is unfavorable, the only expedient may be a loan secured by a pledge of unissued bonds of the railroad, or of its subsidiary railroads, or bonds held in the treasury. The Interstate Commission has directly approved the practice. In approving a pledge by a railroad of its own bonds, the Commission has generally fixed the pledge at a standard ratio of not more than $125 of bonds at current market prices for each $100 in face amount of notes secured.[15] A pledge by a carrier of its own bonds may also occur when the long-term market is closed to most carriers, as at the present time. In order to take advantage of whatever short-term market exists, the road may issue early-maturity notes secured by a pledge of its long-term mortgage

[15] See, for example, 175 I. C. C. 169, 188, 472; 180 I. C. C. 25, 42, 161, 337, 349, 352, 519, 625, 699, 747; 193 I. C. C. 125, 147, 161, 248.

bonds, and, the bonds so pledged will exceed usually in face value the amount of the notes.[16]

The full significance of this security device in current financing is obtained when viewed against the background of the following summary review of the financial and economic emergency of the railroads. At the close of 1931 the total investment in "road and equipment" of the American steam railways, taken as a whole, amounted to some $27 billions. Against this property investment, however, the railroads had outstanding a total funded

[16] In 1932, the railroads issued over $1,000,000,000 of their mortgage bonds, the bulk of which were issued as collateral securing total borrowing of approximately $650,000,000. *U. S. Daily*, Jan. 18, 1933, at 2005. While not all of this amount consists of pledges of the roads' bonds for their own debts, an examination of the Interstate Commerce Commission Finance Dockets covering approvals of Reconstruction Finance Corporation loans indicates that probably 90% of the issues were of this character. For issues typical of the problem under discussion, see the following: The Baltimore & Ohio R. R. Co., I. C. C., F. D. No. 9268, 9659, 10554; Boston and Maine R. R. Co., *id.* 9358; Chicago and Eastern Illinois Ry. Co., *id.* 9154; Chicago and Northwestern Ry. Co., *id.* 9167, 9804, 10637, 10088; The Denver & Rio Grande Western Ry. Co., *id.* 9181, 9562, 9777; Erie Railroad Company, *id.* 9148, 9655, 9936, 10689; Lehigh Valley R. R. Co., *id.* 9308, 9664, 10642; Missouri Pacific R. R. Co., *id.* 9146; The New York Central R. R. Co., *id.* 9180, 9465, 9870; St. Louis-San Francisco Ry. Co., *id.* 9147; Southern Pacific Company, *id.* 9863, 9892; Southern Railway Company, *id.* 9168, 9581. As of December 29, 1934, Reconstruction Finance Corporation net loans outstanding to railroads, and railways and receivers, and trustees thereof in the aggregate amount of $373,855,435 were collateralized by securities whose total principal and/or par value thereof is about $930,000,000, equivalent to approximately 2½ times the face amount of the indebtedness.

debt amounting to $13.3 billions, or, in other words, about one-half the book value of their property.[17] At the end of the same year, forty-five steam railways, large and small, representing about five percent of the total railway mileage of the country, were in receivership.[18]

By 1932, the proportion of railway mileage in receivership had increased to approximately ten percent of the total.[19] The ten Class I roads placed

[17] See I. C. C. annual, Statistics of Railways in the United States, 1931, Statements 17 and 54.

[18] *Id.*, Statement No. 6.

[19] The following statement shows the steam railway mileage in the hands of receivers, as reported by the Interstate Commerce Commission, for each year from the low point of the depression period of 1893 to the year 1933, inclusive:

Steam railways in the hands of receivers and/or trustees, all railways, years 1894 to 1933

Years ended—	Miles of road operated
June 30, 1894	40,818.81
1895	37,855.80
1896	30,475.39
1897	18,861.68
1898	12,744.95
1899	9,853.13
1900	4,177.91
1901	2,497.14
1902	1,475.32
1903	1,185.45
1904	1,323.28
1905	795.82
1906	3,971.43
1907	3,926.31
1908	9,529.03
1909	10,529.80
1910	5,257.03
1911	4,592.89
1912	9,785.83
1913	16,286.18
1914	18,608.21
1915	30,223.05
1916	37,353.45

in receivership during the years 1930, 1931 and 1932, operated some 17,000 miles of line and had a total funded debt at the end of 1931 of approximately $795 millions.[20] As of November 1, 1932, the total railway obligations in default amounted to $410,728,900. In the succeeding twelve months there was an increase of $1,072,790,490.[21]

Total operating revenues of all of the railways diminished from a peak figure of $6,619 millions in 1926 to $4,317 millions in 1931.[22] The total income, after paying operating expenses, taxes, equipment and joint facility rentals, reached its maximum in 1929, with a total of $1,484 millions.[23] By 1931, this figure had dropped to $738 millions. Out of this sum de-

(Continuation of footnote from p. 76.)

Years ended—Continued.	Miles of road operated
Dec. 31, 1916	34, 803. 56
1917	17, 375. 51
1918	19, 207. 58
1919	16, 589. 76
1920	16, 290. 17
1921	13, 512. 35
1922	15, 259. 11
1923	12, 623. 24
1924	8, 105. 24
1925	18, 686. 99
1926	17, 631. 55
1927	16, 751. 88
Dec. 31, 1928	5, 255. 54
1929	5, 702. 92
1930	9, 486. 28
1931	12, 970. 12
1932	22, 545. 14
1933	41, 698. 00

It appears from the table set out above that the railway mileage in receivership or in the hands of trustees in bankruptcy in 1933 was greater than in any previous year of record, and was greater even than during the depression of the early nineties. At the close of 1934, railway mileage in receivership or bankruptcy approximated 42,249 miles, or almost twice the 22,545 miles of 1932. Therefore, despite in

ductions were made in the nature of "fixed charges"[24] amounting to about $73 millions, and interest on funded debt, $580 millions, leaving for stockholders' equity, other than railway intercorporate holdings, a net income of $75 millions for the year.[25] It is to be further noted that of the 167 railway systems of "Class I",[26] 75 failed to cover their fixed charges in 1931, and had nothing left from gross earnings for their stockholders' equity. Bonded interest and guaranteed lease rentals were met only by drawing upon cash balances or by resorting to the expedient of short-term bank loans.[27] And, as has been shown above, such loans could be made, if at all, through private banking channels, only on the basis of pledging corporate securities.

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creased earnings and some improvement in railroad prospects in 1934, the mileage of railroads in the courts tops by a fair margin the previous record total of 40,819 established in 1894. *Cf. New York Times*, January 6, 1935, at C N9.

[20] Clark, *The Internal Debts of the United States*, at 101–102.

[21] Wall Street Journal, Dec. 9, 1933, at p. 4.

[22] The annual average for the five years, 1926 to 1930, was $6,244 millions. *Statistics of Railways in the United States*, 1931, S–54.

[23] *Ibid.*

[24] Includes rent for leased roads, miscellaneous rents, interest on unfunded debt, discount amortization, and miscellaneous income charges.

[25] *Statistics of Railways in the United States*, 1931, S–54. But compare this figure with an annual average of $701 millions during the five years 1926 to 1930.

[26] Companies having annual operating revenues above one million dollars.

[27] See Clark, *op. cit. supra* note 20 at 102.

"Refunding" operations (to the extent of $250 to $275 millions annually) took place during the early months of 1931, but as the year advanced the roads found that new security issues could not be floated. As a result, a considerable number of the roads became heavily indebted to banks and others on short-term loans proceeds of which were used to take up maturities.[28]

As 1932 approached, the two sources open to the roads for meeting their fixed interest payments (short-term commercial bank credit and sale of new security issues) had both contracted in most cases to the vanishing point. With the exception of a relatively small number of strongly entrenched carriers, such as *Norfolk & Western; Chesapeake & Ohio; Union Pacific;* and *Atchison, Topeka & Santa Fe,* receivership or resort to governmental credit or bank credit secured by collateral were alternatives for saving the majority of the road mileage from complete financial collapse.

Primarily to avert this threatened epidemic of receiverships, and to enable the roads to meet their requirements, the Reconstruction Finance Corporation, which was created by the Act approved on January 22, 1932, was empowered by the Act to make short-term loans to railroads. The purposes of the Act are known by its title: "An Act to provide emergency financing facilities for financial institu-

[28] See *Statistics of Railways in United States,* 1930, 1931, Statement No. 42, for increase in volume of railway loans and bills payable.

tions, to aid in financing agriculture, commerce, and industry, and for other purposes" (Appendix, p. 1). Under Section 5 of the Act the Corporation was authorized to make loans "to aid in the temporary financing of railroads and railways engaged in interstate commerce" (Appendix p. 3). The intendement of the Act appears clearly from the above provisions, and from the limitation that the corporation could only make loans to railroads, "when in the opinion of the board of directors of the corporation such railroads or railways are unable to obtain funds upon reasonable terms through banking channels or from the general public and the corporation will be adequately secured" (Appendix, p. 3). On February 2, 1932, the Corporation began its activities.

Let us pause to consider the effect of crippling short-term credit, had there been no crisis—that is, under conditions prevailing prior to 1929. Railroads would have been forced to seek credit by selling these same treasury securities in the open market instead of endeavoring to pledge them.

The first effect would be to increase the control which the New York banking houses historically have had on railroads because the railroads were forced to turn to them for recurrent long-term financing. Short-term loans, offering possibility of being paid off, at least presented a temporary escape. A second effect assumes that investment bankers would have been invoked in any event, either by the railroad or by the commercial banks.

But there is a difference. In the latter case the railroad has at least a chance to pick its own market, and is not necessarily forced to sell at a time when the market is low, or is manipulated, or open market sales will prejudice other legitimate needs of the road. A third possible effect might be that a railroad in desperate circumstances would sell its treasury securities for whatever they would bring. It is a fair assumption that a management group will not usually go into receivership or bankruptcy until it has spent its last resources. In that case *the effect* would be merely to set these securities afloat, swelling the debt structure of the railroad by direct sale instead of by pledgee sale, and (if reorganization were escaped) permanently to burden the road with greater fixed charges.

If it is sought to obviate a swelling of the debt structure, cutting off a line of short-term credit will certainly not do it. Rather, it will tend to increase the swelling of the debt structure.

If it is sought to prevent the dispersal of the assets of the railroad, it may be asked whether any such compelling economic case for that result has been made out as would justify a court in lending its aid toward that result. And it is almost equally questionable whether the Court cares to indulge in an economic presumption as to whether railroad management and railroad reorganization is more desirable when controlled by investment bankers than by commercial bankers.

B. *The injunction invades the contractual rights and not merely the remedy of the Reconstruction Finance Corporation.*

The opinion of the Court of Appeals states (R. 326) that the injunctional order assailed affects merely the remedy, and not the contract rights, of the creditors holding collateral. For authority that "such restraining orders affect the remedy only", the opinion cites *Allebach* v. *Thomas*, 16 F. (2d) 853. But if the reasoning of the court in the *Allebach* case is considered carefully, that decision indicates unequivocally that the injunction in case at bar definitely invades the rights of the Reconstruction Finance Corporation.

In the *Allebach* case, the bankruptcy court was upheld in enjoining the sale of certain real estate by a mortgagee under a State statute. The effect of the injunction, as stated in the opinion, was to require the mortgagee to sell the mortgaged real estate under the supervision of the bankruptcy court and through its trustee rather, than pursuant to the local procedure. The court accordingly held that since the mortgagee's right to sell the property was not denied, but was permitted, even though under the supervision of a different tribunal, the mortgagee's substantial contract rights were not invaded. The reasoning of the court is clearly shown by the following quotation from the opinion (p. 855): "The remedy may be altered without impairing the obligation of his contract, *so long as an equally efficient and adequate remedy is substituted.*" (Italics supplied.)

Neither the reasoning nor result of this case apply to the present proceeding. Here the Reconstruction Finance Corporation is permitted no corresponding right of sale under the supervision of the bankruptcy court. As the Court of Appeals has stated, the object of Section 77 is the consummation of a plan of reorganization. Until it can be seen whether this object can be accomplished, the pledgee will not be permitted to sell the pledged property. Instead, his claim is transformed into a nonvoting proprietary interest for an indefinite period, with no assurance that a plan can ever be effected under the Act.

By a denial of the remedy without the substitution of any equivalent, the contract right is definitely and unquestionably invaded. Mere *postponement* of the remedy for a period as short as twelve months is an impairment of the contract right, although such impairment by State law has recently been held permissible when required by and reasonably adapted to meet an economic emergency. *Home Building and Loan Association* v. *Blaisdell*, 290 U. S. 398.

It would seem from the order of the District Court and from the opinion of the Circuit Court of Appeals, that the present injunction will be maintained in force until a plan of reorganization has been prepared, submitted, and adopted; or until it is apparent that no plan of reorganization can be agreed upon. The period of time that may be required for the effectuation of such a proceeding is unpredictable. Throughout this long and unpredictable period the right of sale given the Reconstruction Finance Corporation

by the contract will be denied without the substitution of an equivalent remedy. We submit that the unwarranted order of the District Court definitely invades the contract right itself. The denial of the means to enforce a contract is an abrogation of the contract. *W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426, 433.

C. *Congress, through the Reconstruction Finance Corporation Act, elected to follow the policy during the existing emergency, of financing railroads by short-term collateral loans from the Reconstruction Finance Corporation, each transaction being controlled by the Interstate Commerce Commission as guardian of the soundness of financial policy. This amounts to a Congressional determination of financial policy which, as a matter of sound government, this Court should not override.*

The Congressional policy in question was foreshadowed by administrative action of the Interstate Commerce Commission in 1931.

The Railroad Credit Corporation was organized at the close of 1931 to administer the proceeds obtained from the special freight rate increases authorized by the Interstate Commerce Commission in October of that year. It partially assumed responsibility for financing railroad requirements by short-term loans secured by collateral.[29]

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[29] See, in general, *Fifteen Per Cent Case*, 1931, *Ex parte No. 103*, 178 I. C. C. 539; 179 I. C. C. 215; *47th Annual Report of the Interstate Commerce Commission* (1933) at 11–12; *Moulton, The American Transportation Problem* (1933) at 67–68.

In January of 1932 direct government intervention took place.

From the date of its organization, February 2, 1932, up to December 22, 1934, the Reconstruction Finance Corporation has received the approval of the Interstate Commerce Commission upon applications from railways for a total of approximately 460 millions of loans to 82 roads.[30]

The Reconstruction Finance Corporation has outstanding with 36 Class I carriers, constituting many of the most important systems of the country, loans averaging more than $10,000,000. The loans to these 36 Class I carriers aggregated, as of December 29, 1934, $367,756,962, comprising as of that date 98.4 percent of all outstanding loans to railroad

[30] *Authorized loans to railroads by Reconstruction Finance Corporation, as of December 29, 1934*

Loans were authorized to railroad companies by Reconstruction Finance Corporation for the following purposes:

For interest	$121,664,291
For equipment trusts	40,839,765
For bonds and other funded obligations	107,862,993
For loans from banks	37,793,900
For other loans	16,200,587
For work loans, rebuilding and/or construction of equipment, etc	8,905,577
For additions and betterments, new construction	53,499,341
For taxes	31,987,308
For wages, past due vouchers, etc	23,165,768
For miscellaneous	15,936,550
Total amount authorized	457,856,080
Cancellations to date	5,207,556
Authorizations less cancellations	452,648,524

(Table prepared by Railroad Division, Reconstruction Finance Corporation.)

borrowers. As collateral security for the loans to these 36 Class I railroads, the Corporation holds securities of a *face* value of approximately $930,000,000, or a ratio of over two and one-half to one. As was pointed out above, the excess of *face* amount of the collateral over the actual loans is not anomalous since the preponderance of the deposited collateral is composed of junior securities of the borrower, and/or stock or securities of, and/or assignment of advances to subsidiary or affiliated companies, which have been the only collateral available to the borrower.[31]

The indebtedness of the debtor and the amount of collateral holdings for the said indebtedness has been set out above.[32] The percentage of the *face* value of the collateral received from this debtor does not differ materially from the percentage in the case of other carriers of equal or greater importance, nor does the percentage of the *value* of the collateral. (See value put upon the collateral by the debtor, Appendix, p. 83.)

The present case involves only the usual loan made by the Reconstruction Finance Corporation to a railroad, secured by the usual amount of collateral.

Restraint by the District Court of the exercise by the Reconstruction Finance Corporation of the powers

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[31] That the Reconstruction Finance Corporation was intended to make loans of exactly this character is evidenced from the hearings held in connection with the establishment of the Corporation. See, in this respect, *Hearings Before the Committee on Banking and Currency on H. R. 5060, 5116, 72d Cong., 1st Sess.* (1932), pp. 57–58, 67.

[32] See, *supra*, pp. 3–4.

expressly granted to it by the terms of the notes it holds, and in Section 5, not only puts in question the adequacy of the security taken for the $457,856,080 of railroad loans authorized as of December 31, 1934 under Section 5, but likewise jeopardizes the security for loans authorized under the Emergency Relief and Construction Act of 1932, subdivision (f) of which contains an identical grant of express powers with respect to loans made thereunder.[33]

The Interstate Commerce Commission took an active part in developing the Congressional policy laid down by the Reconstruction Finance Corporation Act.

Not only has the Interstate Commerce Commission approved the instant loans to the debtor but applications when filed are public records, publicity thereof immediately appears in the press and the Commission has always been ready to receive, and give consideration to, objections from security holders of the debtor to the application for, and the granting of, the instant loans.

The Congress squarely had before it in 1932 the problem of meeting the railroad situation. It might have done so by permitting railroads simply to go into receivership; but it elected a different course. The Interstate Commerce Commission had initated, in 1931, through the medium of the Railroad Credit

[33] See Appendix, p. 3. Under this Act, as of December 31, 1934, 177 loans were authorized in the aggregate amount of $245,647,055 and disbursements, as of the same date, amounted to $123,095,702.

Corporation,[34] the policy of secured short-term loans to weak carriers. The Reconstruction Finance Corporation was authorized to make loans on adequate collateral for a period of not to exceed three years;[35] and thereby the Congress virtually laid down a policy in favor of this method of dealing with the situation.

In view of this determination of policy, can the courts now say that it is an undesirable economic policy and that a strained construction of a statute should be adopted to nullify it? To do so would be to take the courts very far into the domain of executive government, a responsibility which the judicial arm is, we believe, loath to undertake.

It may be assumed that such loans were "to aid in the temporary financing of railroads and railways", and that the Interstate Commerce Commission as a condition precedent to granting those loans held hearings; carefully examined the financial condition of the railroad; considered the public's interest; prescribed the collateral to be pledged under the loan and the term of the loan. It had discretion to refuse to do so or to impose additional conditions. The Congress did not leave the granting of the loans in question to haphazard chance or even to the discretion of the Reconstruction Finance Corporation.

Where the policy involved is not declared, the problem of economic desirability may be open. But

[34] See *supra*, p. 84.

[35] See Reconstruction Finance Corporation Act, Sec. 5, Appendix, p. 2.

where the Congress has indicated a general standard of policy, and has left its application to an expert body charged with the duty of developing a policy, should that policy now be overridden by a process of strained statutory construction?

The theory that the District Court desired to avoid interrupting a "pledge" but concentrated rather on a legalistic distinction which envisaged a radical revision of the "remedies" available to a pledgee is without merit. If the remedy is deleted, what is there left of the pledge? The purpose of a pledge is precisely to avoid sharing in the hotchpot of a bankruptcy administration; this is why pledges allow the collateral to be taken over.

The pledge and its remedy should be considered together: no valid basis exists for distinguishing them. Certainly they should be considered together, where the exercise of the remedy is incident to a determination of financial policy by the Congress, which as a matter of sound government, this Court should not override.

IV

NO NECESSITY HAS BEEN SHOWN FOR THE ISSUANCE OF THE INJUNCTION.

The order[36] of the District Court is based upon the following findings which upon analysis are mere assumptions:

(a) That certain collateral consisting of bonds of the debtor, or of its subsidiaries, and certain stock were pledged under three of the debtor's mortgages.

[36] See R. 101.

(b) That the sale of the collateral held by Reconstruction Finance Corporation and the banks would in effect, prevent the debtor's reorganization.

(c) That "it is necessary for the enforcement of the provisions of Section 77" that the sale of said collateral be enjoined "pending the preparation and consummation" of a reorganization plan.

Assumption (a) is not material in this case, without a finding (which the District Court properly failed to make) that a determination that the Reconstruction Finance Corporation had a right to sell its collateral would determine the right of the mortgage trustees to sell. As we have heretofore shown assumptions (b) and (c) are unsupported by any properly pleaded facts or evidence of record. The issuance by District Court of the order constitutes reversible error.

Upon analysis assumptions (b) and (c) rest upon two fallacies; that (1) the sale will cause such shifting of classes of creditors or such changes in the size of the various classes of creditors, or (2) such increase in the debt structure, as would prevent the debtor's reorganization.

It is the position of the Reconstruction Finance Corporation that under Section 77, pledged bonds must be treated as already outstanding for the purposes of the approval of a plan and, hence, there can be no shifting of classes of creditors or changes in the size of the various classes of creditors sufficient to prevent a plan being approved. It is further the position of the Reconstruction Finance Corporation, that, in the particular circumstances of this case, no

necessity was shown in the District Court for the issuance of the injunction.

We shall dispose of the first of these propositions, before directing the attention of this Court to the second.

A. *Under Section 77, the pledged bonds must be treated as outstanding for the purposes of the approval of the plan, and hence there can be no such shifting of classes of creditors or such changes in the size of the various classes of creditors as will prevent the preparation and effectuation of a plan.*

From the last sentence of subdivision (b) of Section 77, it clearly appears that claims represented by securities of the debtor held as collateral must be treated as outstanding for the purposes of the reorganization plan, its acceptance and confirmation; viz:

> The term "creditors" shall, except as otherwise specifically provided in this section, include, *for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims,* interests, or securities *of whatever character* against the debtor or its property, including claim for future rent, *whether or not such claims, interests, or securities would otherwise constitute provable claims under this Act.* (Italics supplied.)

No other specific provision in the Act prevents claims represented by securities of the debtor held as collateral from being included in classes of outstanding securities for all the purposes of the Section, including the voting upon a plan. Such claims must,

therefore, be treated as outstanding under the express provision of law above quoted for all the purposes of the Section. It is of little practical difference, so far as voting upon the plan is concerned, whether the Reconstruction Finance Corporation holds its collateral intact or assigns or sells the whole or a fractional interest thereof, since in any event "*all* holders of claims, interests, or securities of whatever character against the debtor or its property, * * * whether or not such claims, interests, or securities would otherwise constitute provable claims" under the Act, are entitled to vote upon the approval of a plan.

If, as indicated by the clear wording of the Act, holders of notes secured by collateral are entitled to vote, both as noteholders and in the respective classes in which they hold collateral, it is difficult to see what practical effect the sale of collateral could have upon the preparation and effectuation of a plan. There is no shifting of classes nor is the size of classes increased. The result accomplished is merely a substitution within a given class of one creditor for another.

B. *The sale of collateral by the Reconstruction Finance Corporation will not prevent the reorganization of the debtor.*

All but $7,575,000 face amount of the collateral held by the Reconstruction Finance Corporation consists of the *secured* obligations of subsidiaries of the debtor.

(i) The pledged collateral consisting of the secured obligations of subsidiary companies must be recognized in any plan of reorganization, whether it is sold or remains pledged.

It cannot be assumed that the debtor has itself guaranteed all of the subsidiary companies' bonds, since this is not the fact.[37]

In the absence of any allegation to the contrary in the petition for this injunction, it must be presumed that all the bonds of the subsidiary companies were negotiated to the debtor, and constituted property in its hands prior to the time of the pledge.[38]

If bankruptcy proceeding had been commenced before any pledge was made, the debtor company, as owner of these securities would have been entitled, in any liquidation, to realize on its lien, and enforce its debt on each of these bonds against the subsidiary companies. Creditors of the debtor (especially creditors having no security) would be entitled to insist upon this. Otherwise a valuable asset of the debtor itself would be handed over to the subsidiary company for the benefit of the subsidiary's creditors, and at the expense of the creditors of the debtor.

[37] If the full record is examined, statements may be found showing that two of the seventeen bond issues pledged with the R. F. C. are in some sense guaranteed by the debtor. This is contradicted by other statements that the debtor agreed to pay the *interest* as *rental* (R. 29), in which case the transaction, being a lease, would be voidable by the trustees. In any event the debtor, if it is in fact a guarantor, could insist on reimbursement from the subsidiary in case it was forced to pay.

[38] The record elsewhere affirmatively shows this is the case. (R. 13.)

Since each separate railroad (assuming, but not conceding, that it is part of one system) has its own creditors, the property of each railroad must be separately considered, and inter-company claims recognized, in order to provide each creditor with his proper share of the assets. Each railroad is a separate corporation with its own property and creditors, and a plan, to be fair and equitable to the respective conflicting interests, *must* make proper provision for the creditors of each company.

These subsidiary bonds were already outstanding, and were debts of the subsidiary companies even before the pledge.

They do not cease to be an indebtedness, or cease to be outstanding, whether in the portfolio of the debtor as property, or pledged to a lender as collateral security for the loan. There can thus be no "increase in the debt structure" by the sale of the subsidiary bonds. They are no less enforceable before a sale by the pledgee than after such a sale.

(ii) All the pledged collateral must be treated as outstanding, unless the pledgee is to be deprived of the benefit of his contract.

It may be urged the sale of the collateral would dilute the interests in the trust estate of the holders of certain bondholders and other creditors of the debtor, and of the debtor itself. Without conceding that this would be the result, it is a result arising from the use of rights which the pledgees paid for and which were granted to the pledgees by the debtor itself in the valid exercise of its corporate powers. (See Appendix,

pp. 24 and 64, 65.) No rights of the bondholders or other creditors of the debtor were violated by the contract between the debtor and the pledgees. Indeed, the Reconstruction Finance Corporation, at the risk of loss to the Government, advanced the Government's money in an effort to save the enterprise for the benefit of all parties including the bondholders and creditors. So far as dilution of the interests of the various parties is concerned, the sale of the collateral would dilute such interests, if the debtor had not filed a petition under Section 77. No one would contend that in such case the sale could be enjoined by any bondholder, creditor, or by the debtor on the ground of dilution. There is nothing in Section 77 that authorizes a court to take away rights from one class of creditors for the benefit of other creditors. This seems to have been the real object of the debtor's petition.

Furthermore, it should be repeated that the pledge of the collateral was authorized by due corporate action of the debtor, and of the Interstate Commerce Commission (the administrative control established by Congress); and that the validity of the pledge is not questioned by the respondents. To invalidate the pledge in these circumstances is to deny to the pledgee the benefit of his contract, in order to give to other creditors of the debtor, and to the debtor itself, an advantage for which they had not bargained.

The District Court's assumption that if the pledged collateral is sold, there would be an increase in the debt structure, which would in some unexplained

way prevent a reorganization being effected, is unrealistic. The assumption is unsupported by any facts of record.

Assuming (but not conceding) that there would be such an increase, the finding that an increase will prevent a reorganization of the debtor is a pure assumption and nothing more. It is bad reasoning to say that, while a plan of reorganization for liabilities of the debtor amounting to $400,000,000 can be effectuated, none can be consummated providing for liabilities of $600,000,000. The very statement of the proposition shows its absurdity.

(iii) Power to sell collateral instead of tending to "hinder, impede, obstruct, delay, and in effect prevent" consumation of a plan of reorganization will in practice expedite it.

The order of the District Court is predicated upon the unwarranted assumption that the power to sell the pledged collateral tends to obstruct the consummation of an orderly plan of reorganization. While historical material may not be particularly instructive, a realistic approach shows the fact to be exactly the opposite.

The power to sell collateral has existed wherever railroads went into receivership before enactment of Section 77; and reorganization of those roads has been consummated. It is probably true that the short-term debt secured by pledge in many, if not all, of these cases in recent years, was materially less than the short-term debt of railroads now in diffi-

culties, and of the debtor here. This, however, is no reason why the power of the holders of this short-term debt to sell their collateral is an obstacle to the debtor's reorganization.

On the contrary, removal of the power to sell collateral removes likewise a powerful motive for consummating and completing a plan. The pledgee-creditor, if the debtor's contention is sustained, is denied the right to reduce his collateral to ownership and thereupon to insist that the debtor either meet his obligations, compromise them by a plan of reorganization, or surrender the property. The debtor, within the sheltering haven of an injunction, may simply wait—this at the expense of the creditor. If waiting proves the wrong policy, the creditor loses. If conditions change for the better, the creditor is paid off or a compromise reached; all, apparently, at the option of the debtor.

The Court will, we believe, take judicial notice of the fact that a railroad reorganization is essentially a bargaining process between creditors and security holders. The result turns largely on the position of the respective parties. A mortgagee able to foreclose has one position. A mortgagee unable to foreclose has another. A note holder, separated by injunction from mortgage collateral, has almost no bargaining power at all, and may be dealt with lightly in the timing of the reorganization or in ultimate distribution of new securities. These considerations are particularly compelling in the case at

bar. Here the short-term debt is so large that it is hardly conceivable that the short-term debt can be paid off in cash on reorganization.

With holders of outstanding secured notes free to act, there is a powerful lever tending to overcome dilatory tactics on the part of the debtor or the other creditors. If, however, they are prevented from acting, the debtor and his other creditors have a positive incentive to delay a plan. By waiting, the debtor and other interests can literally gamble with the noteholders' money.

Most of this short-term debt of the debtor represents loans from the Reconstruction Finance Corporation, which went in part to pay interest on the very bonds (see Appendix, pp. 28, 29, 70) represented by some of the committees, which have urged this injunction. A part went to pay off loans to the debtor by the banks, which in consideration of such payment, extended the balance of their loans to the maturity date of the new loan made by the Reconstruction Finance Corporation (Appendix, p. 41). In other words in place of a large amount of bonds sold just prior to receivership (which bank creditors normally do when receivership impends), the Government, by its short-term operations, has minimized the outstanding indebtedness of the railroad for the benefit of existing bondholders (some of these loans, as mentioned, were used to pay bond interest), and to maintain the financial structure of the railroad.

Unless this Court upholds the contention made in this brief that, under subdivision (b) of Section 77,

the holders of notes secured by collateral, for all purposes of this section and in particular for the purpose of voting upon a plan, are entitled to vote both in the class of note-holders and in the respective classes in which their collateral falls, the Reconstruction Finance Corporation also will stand a fair chance, in any reorganization, of being offered junior securities of low value, instead of securities of a priority and quality which recognizes the mortgage position of its collateral. The Government, through the Reconstruction Finance Corporation, will suffer because of the very benefit it has conferred. This, too, in violation both of the normal economic process and of the institutional practice of many years' standing.

It is difficult to understand why bondholders who purchase bonds ~~prior~~ to receivership at a pledgee sale from banks, should be favored in contrast with the Government which has held claims at a minimum by holding its collateral and maintaining the structure.

This is a matter of grave concern to the Government. In many cases the Reconstruction Finance Corporation is the largest single creditor of railroads. Its claims are all short-term debts secured by collateral as the Reconstruction Finance Corporation Act requires. If there is a loss, it falls ultimately on the taxpayers of the United States. It is not easy to see why the taxpayers should be sacrificed to bondholders or to the interests of a corporate debtor; and

it is impossible to see how that process avoids any obstacle to reorganization.

V

THE PRESENT INJUNCTION IS NOT A MERE TEMPORARY RESTRAINING ORDER

A. *When, may we ask, is the Reconstruction Finance Corporation to be permitted to sell its collateral?*

The order of the District Court is predicated upon the assumption that the injunction is necessary to effect a reorganization. The order purports to be a final disposition of the issue until a plan of reorganization is effected, or the proceeding under Section 77 dismissed. Since the filing of a petition under Section 77 of the Bankruptcy Act is a privilege of the debtor, the construction placed on the Act by the District Court virtually reduces a pledgee, in a case like the present, to the mercy of a debtor who has filed under Section 77, irrespective of the final nature of the reorganization, or the provision ultimately made for the collateral held by secured note holders.

The case at bar is illustrative of the point. Nowhere in the record in this case is there a showing that a plan of reorganization of the debtor is even in process of formulation by any of the interested parties, although subdivision (d) of Section 77 requires that the debtor *shall* present to the Interstate Commerce Commission a plan of reorganization.

The attitude of the debtor's reorganizers is strikingly revealed by the following excerpts containing a summary of the minutes of a meeting of the creditors

of the debtor and other interested parties, held on October 11, 1934: [39]

> Mr. Beebe, of the First and Refunding Committee stated that, in his view, any reorganization should be permanent and not temporary; that any reorganization attempted at this time would result in too great sacrifice to the holders of bonds, and that it is not fair to them to ask them to do that. The Chairman of the trustees thereupon said that in view of the fact that it seemed impossible for a proper reorganization to be brought about, perhaps the spirit of Section 77 could not be carried out and perhaps it was the duty of the trustees to so report to the Court and resign * * *.
>
> The Chairman thereupon asked the meeting what they considered to be the duty of the trustees in the premises. Mr. Root replied that if a plan were presented at the present time it would undoubtedly fail to receive the necessary approval of the various classes of creditors and the Court would thereupon have immediately before it a motion to dismiss these proceedings, and if the proceedings were dismissed it would be followed by an Equity Receivership. The Chairman asked if that would help matters and Mr. Root said no, that the situation would be much worse and with this proposition there seemed to be general assent.
>
> Mr. Bailey said that he regarded it as impossible to make a permanent reorganization

[39] For certified copy of letter from Trustees of debtor to Director, Bureau of Finance, I. C. C., appearing in the Commission's Finance docket No. 10028, see Appendix, p. 167.

under the present conditions. In this view Mr. Kitchel agreed, as did Mr. Bogue and Mr. Moulton.

The Chairman thereupon asked if there was anyone present who thought it was possible or advisable or the duty of the trustees, to present a reorganization plan at this time and there was no response.

* * * * * *

Since the date of such meeting several other general meetings with the representatives of the various interests in the Trust Estate have been held and the affairs and the financial condition of the Trust Estate laid before and discussed with them, and no one has suggested to the trustees that they believe it advisable to formulate and propose a plan of reorganization under the existing conditions. [40]

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[40] It should not be presumed that the incidence of delay characteristic of the case at bar is at all anomalous; protracted delay has been characteristic of the reorganization of American railroads. The average duration of the railroad receiverships between 1894 and 1931 of roads operating more than 100 miles was in excess of 4 years. Based on *Interstate Commerce Commission Bureau of Statistics*, Statement No. 33206, File No. 52–A–2; I. C. C. Ann. Rep. on Statistics of Railways in U. S. Section 77 apparently does not offer abundant promise that the situation in this respect will change. This Court will, we believe, take judicial notice of the fact that altogether fifteen proceedings, (of which one by a small property has been dismissed) have thus far been instituted under the new section. This figure does not include those subsidiary and/or affiliated carriers which filed petitions in the same proceeding as the debtor-parent. Of those proceedings pending there are five involving large Class I roads, instituted on the dates, in Federal district courts, in cities, as follows: Missouri Pacific Railroad Company, filed on March 31, 1933 (St. Louis); Chicago and Eastern Illinois (the C. & E. I.),

B. *Unless the Reconstruction Finance Corporation is afforded by this Court the relief to which it is clearly entitled, it will suffer further hazard and possible irreparable harm.*

We beg to call to the attention of the Court that no bond or other security was exacted by the District Court so that the Reconstruction Finance Corporation must take the entire risk which arises from a further depreciation in the value of its collateral, pending the dissolution of the District Court's order.

At a time when the railroads of the country are faced with a major financial crisis due to lack of business, the competition of unrestricted forms of transportation, and a rise in operating expenses due to wage increases, compulsory pensions, and the

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April 18, 1933 (Chicago); St. Louis-San Francisco Railway Company (the Frisco), May 16, 1933 (St. Louis); Chicago, Rock Island and Pacific Railway Company (the Rock Island), June 7, 1933 (Chicago); and Chicago, Indianapolis & Louisville (the Monon), December 30, 1933 (Chicago). The other ten cases involve minor properties, viz: Alabama, Tennessee & Northern Railroad Corporation; Akron, Canton & Youngstown Railway; Arkansas Valley Interurban Railway; Chicago, South Shore & South Bend Railway; East St. Louis, Columbia & Waterloo Railroad; Fonda, Johnstown & Gloversville Railroad; Kansas City, Kaw Valley & Western Railway; Meridian & Bigbee River Railroad; Minarets & Western Railroad; Spokane International Railway Company. Only three of these were instituted in the year 1934, viz: Alabama, Tennessee & Northern Railroad Corporation, December 14, 1934; East St. Louis, Columbia & Waterloo Railroad, October 31, 1934; Kansas City, Kaw Valley & Western Railroad, August 10, 1934. The slow rate of progress toward a reorganization plan of these five major Section 77 cases has called forth comment from at least one student of railway transportation problems. See *Wehle, Railroad Reorganization Under Section 77 of the Bankruptcy Act; New Legislation*

increased cost of coal and other materials, this risk is substantial.[41]

Since the District Court's order is predicated upon the necessity of the injunction until a plan of reorganization can be effected, unless this Court now affords the Reconstruction Finance Corporation the relief to which it is clearly entitled, the latter can have no assurance that it will not suffer irreparable injury.

CONCLUSION

This was an order granted in a summary proceeding for which there was no specific statutory warrant. No facts were shown which would have warranted the order had this been a plenary proceeding. No such power either in plenary or summary proceeding existed prior to the enactment of Section 77 of the Bankruptcy Act; every canon of statutory construction refutes the suggestion that such power can

Suggested, 44 Yale Law J. (1934) 197, 202. Moreover, it is to be noted that under the Act and the special bankruptcy rules promulgated by this Court for practice under it, the debtor or trustee must file in court a classification of creditors and of stockholders before the Commission can hold a public hearing upon a plan of reorganization. In the *Missouri Pacific case* it took the debtor seventeen months to do this; in the *Rock Island case*, seven months; in the *Monon case*, eleven months; and in the *C. & E. I. case*, eighteen months; while on June 5, 1933, a classification order was filed in the *Frisco case*, the plan to which it was related has, for all practical purposes, been abandoned. Of these five major Section 77 proceedings, a serious reorganization plan has been filed with the Interstate Commerce Commission in only one case, the *C. & E. I.* See *Wehle, Railroad Reorganization, supra.*

[41] For an indication of the cumulative effect of these adverse influences upon the earnings of the debtor since the date of the injunction, see petition of the Trustees to the District Court. (Appendix, p. 164.)

be implied from Section 77 or the so-called "omnibus clause" of the Bankruptcy Act (clause 15 of Section 2). The Reconstruction Finance Corporation Act has explicitly given to the petitioner a right to take over and liquidate pledged collateral; this statutory right would continue even if the implication could be indulged as to other creditors.

The economic policy of financing railroads by short-term loans secured by pledge was recognized by the Congress in the Reconstruction Finance Corporation Act, and given specialized administrative control by the Interstate Commerce Commission; that policy can hardly be called into question here. Indeed, support of the policy embodied in the decision of the Circuit Court of Appeals would have such far-reaching and dangerous effects as to perpetuate corporate holdings of securities both in railroad and nonrailroad corporations and to endanger normal commercial processes.

The order was predicated on so-called findings of fact; no evidence in the record appears to support those findings, and, indeed, the public records in the case, and in many instances the record itself, shows these assumptions to have been consistently contrary to fact. The order is assumed to be in aid of a plan of reorganization; it affirmatively appears that no plan of reorganization is in prospect. An order predicated on naked assumptions cannot stand, though these assumptions be called findings of fact.

The supposed distinction between interruption of a remedy and impairment of a right is meaningless in this case.

Realistically, this decision is tantamount to judicial legislation: economic policy is reversed; the settled law is changed without statutory warrant; the right of a pledgee to the position for which he bargained is postponed indefinitely and probably forever; and his position and bargaining power in the ensuing reorganization is impaired, if reorganization ever can be accomplished in a stalemate such as now exists.

There was and is no basis for the decision of the courts below either in the statutory or case law.

The judgments of the Circuit Court of Appeals should be reversed and the causes remanded to the District Court with instructions to vacate the injunctional order (R. 104), and so much of the order (R. 7) approving the debtor's petition under Section 77 as denies to this petitioner the right to dispose of the pledged collateral pursuant to the terms of the debtor's notes held by it.

Respectfully submitted,

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